The Financial Reporting Council has published a significantly updated final-form Stewardship Code. This aims to set a high bar for stewardship by asset owners, managers and their service providers while recognising that there are a variety of business models, objectives and resources within the investment management industry. The Code applies from 1 January 2020.

The wide-ranging definition of stewardship in the consultation draft published last January has been toned down to clarify that the primary purpose of stewardship is to benefit clients and beneficiaries. The FRC expects that good stewardship will, in turn, lead to wider benefits for the economy, environment and society and be applied to all types of investment, whether or not these are based in the UK.

The Financial Conduct Authority has been working closely with the Financial Reporting Council to achieve an appropriate balance between the encouragement and regulation of stewardship activities. New Financial Conduct Authority rules on shareholder engagement for life insurers and asset managers which implement the EU Shareholder Rights Directive (SRD II) came into effect last June (see PS 19/13). In a statement published at the same time as the new Code, the Financial Conduct Authority confirmed that it will not impose further stewardship rules at present (see FS 19/7).
Key changes
The main changes are as follows:

> a new definition of stewardship
> an extended focus that includes asset owners, asset managers and service providers;
> signatories must report annually on stewardship activity and its outcomes;
> signatories are expected to take account of environmental, social and governance factors;
> signatories should explain their stewardship across a wide range of asset classes; and
> signatories must explain their organisation’s purpose, investment beliefs, strategy and culture.

Definition of stewardship
The new Code seeks to set a clear benchmark for stewardship as “the responsible allocation, management and oversight of capital to create long-term value for clients and beneficiaries leading to sustainable benefits for the economy, the environment and society”.

Stewardship activities include pre-investment analysis, monitoring assets and service providers, engaging issuers and holding them to account on material matters and working with others to influence issuers and to manage market risks.

Different asset classes and geographies
The Code recognises that the investment market has changed significantly since the first UK Stewardship Code was published in 2010. As a result, the Code expects stewardship will cover all types of investment beyond listed equity, including, in particular, fixed income, but also real estate, private equity, infrastructure and investments outside the UK.

As these investments have different terms, investment periods, rights and responsibilities, signatories will need to consider how to exercise stewardship to fit their particular circumstances and level of influence.

Scope of the Code
The Code sets out expectations for different entities in the investment chain. A set of 12 Principles applies to asset owners and managers, whilst a separate six Principles are for those providing investment services, including proxy advisers, investment consultants and data and research providers. This extended focus aims to align the approach of the whole investment community for the benefit of end-investors and beneficiaries.

The Principles are supported by reporting expectations which indicate the information that signatories should report on.

Reporting on stewardship activities and outcomes
There is a strong focus on the activities and outcomes of stewardship. Signatories are required to report annually to show what has actually been done in the previous year and what the outcome was, including engagement with the assets invested in, records of how votes have been cast and how the value of investments has been protected. This is meant to provide greater transparency so that client can evaluate how their interests are being served.

Stewardship Reports should be contained in a single document and give a clear and specific picture of how the Code has been applied, using engaging, succinct and plain English. The Reports should be fair and balanced, but acknowledging setbacks experienced and lessons learned, as well as successes. It is not necessary to describe stewardship activities on a fund-by-fund basis or according to different investment strategies. Reports should be approved by the governing body and signed off by a senior official, such as the chair, CEO or chief investment officer.
The consultation suggested signatories should provide an initial Policy and Practice Statement, as well as an annual Activities and Outcomes report. This recommendation has been removed following strong support for a single Stewardship Report on actions taken.

**Purpose, beliefs, strategy and culture**
Signatories will need to explain their organisation’s purpose, investment beliefs, strategy and culture and how these enable them to exercise stewardship. Signatories should also show how their governance, resourcing and staff incentives contribute to effective stewardship. This recommendation aims to align the Stewardship Code with the updated UK Corporate Governance Code 2018 which recommends that listed companies should articulate their purpose and culture.

**ESG and climate change**
The Code recognises that environmental, particularly climate change, and governance and social factors have become material issues. Investors are expected to consider them when making investment decisions and undertaking stewardship and to ensure that they align their interests with the needs of their clients.

The Code also sees asset owners and managers as important guardians of market integrity working to minimise systemic risks as well as taking care of the investments in their portfolios.

**Signatories under the old and new Code**
Organisations wanting to become signatories to the new Code must produce a Stewardship Report explaining how they have applied the Code in the previous 12 months. The FRC will evaluate these Reports against their assessment framework and list as signatories to the Code only those organisations that meet the reporting expectations.

To be included in the first list of signatories, organisations must submit a final report to the FRC by 31 March 2021. The FRC will assess reports and publish a list of signatories to the 2020 Code in the third quarter of 2021.

The FRC will continue to accept applications to the existing UK Stewardship Code until 31 December 2019 and organisations that are currently signatories will retain this status until the first list of signatories to the 2020 Code is published. Existing signatories must submit a Stewardship Report that meets the FRC’s new reporting expectations in order to continue to be listed as signatories to the UK Stewardship Code.

**Enforcement and regulation**
The FRC intends to expand its stewardship team and to work with the Department of Business, Energy and Industrial Strategy (BEIS) to keep its enforcement and regulatory powers under review. It will assess the Code’s effectiveness by:

- monitoring the quality of reporting of signatories which apply the Code;
- ongoing engagement with stakeholders;
- reviewing how the market uses stewardship reporting; and
- working with other regulators, including the FCA.

**More information**
This publication is intended merely to highlight issues and not to be comprehensive, nor to provide legal advice. Should you have any questions on issues reported here or on other areas of law, please contact one of your regular contacts, or contact the editors.

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