Consultation response: FRC's UK Stewardship Code Additional Guidance

IIGCC Response to the FRC's UK Stewardship Code Additional Guidance

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About

The Institutional Investors Group on Climate Change's (IIGCC) is an investor-led membership organisation. We bring the investment community together to make progress towards a net zero and climate resilient future. We work with our members to create guidance, tools, frameworks and resources that can help them, in their individual contexts, in managing climate-related financial risk within their portfolios and making the most of opportunities presented by the transition towards a decarbonised global economy and the realities of a changing climate. We have 400+ members across 20+ countries. More information at www.iigcc.org

Introduction

IIGCC welcomes the FRC's proposed additional guidance to the UK Stewardship Code. It provides sought-after support for signatories seeking to improve the quality and consistency of their reporting in a flexible manner. The draft guidance lifts the ambition of the Code and its signatories, articulating to signatories what "effective reporting" might constitute, helpfully providing insight, not instruction.

The FRC's commitment to dialogue with practitioners and willingness to take on suggestions is welcomed and will help to ensure that the guidance is relevant, practical and useful from first publication through its evolution. We look forward to future opportunities for practitioner input over time.

Suggestions

In addition to these overarching positives, there are number of areas we would like to draw out, voice our support for, and provide suggestions on: 1) Definitions, 2) Approach to collaborative engagement, escalation and systems stewardship, 3) Case studies, 4) Approach to different asset classes and investment styles and 5) Resourcing.

1. Definitions

a) *Outcomes*

The guidance accelerates the positive steps first taken in the FRC's interim changes to expand the definition of outcomes. The guidance now recognises that outcomes may be ongoing and may not be successful. Outcomes may range from changes at the company, to a better understanding of management decision-making, to building long-term relationships, and finally to alterations to the investors' own investment/stewardship decisions. This sophisticated and nuanced understanding of outcomes better reflects the realities of stewardship, especially the typically long-term, multi-year nature of climate change-related engagement, and clears the road for more honest reporting.

However, while welcomed and necessary, this broader definition of outcomes may present challenges to the comparability of reporting and ultimately risks a shift away from real-economy outcomes in favour of processes. Asset owners, in particular, seeking to understand how stewardship activities have resulted in real-economy impact, may benefit from the guidance recommending a distinction between company-level (e.g. reduced Scope 1 & 2 emissions) and investor-level outcomes (e.g. change (or lack of) in investment conviction). Company-level outcomes can be out of the investor's control and difficult to attribute but create real-economy impacts. Investor-level outcomes are within the investor's control but may not have immediate real-economy impacts, even if they may be necessary stepping stones towards this desired outcome. Distinguishing between the two would provide clarity and comparability.

b) *Engagement*

The expanded definition of outcomes would benefit from being paired with further clarity on the definition of engagement.

While we recognise the value of flexibility, the current breadth of interpretation for what constitutes an engagement risks undermining comparability and ambition, potentially conflating deep and meaningful, resource-intensive engagements with light-touch approaches. This presents a particular challenge for asset owners overseeing multiple external managers, where inconsistent definitions make it difficult to assess and compare stewardship practices.

We suggest the guidance encourage signatories to set out how they categorise engagements; for example, distinguishing between engagement for information and engagement for change, which both constitute meaningful and legitimate forms of engagement, and explaining their categorisations and providing a breakdown of their activities during the year. The extent to which engagements are pursued for information rather than change, or vice versa, can then be contextualised within the investor's broader theory of change and stewardship/investment strategy. This would provide insight into the investor's approach to engagement and enhance comparability.

c) *Sustainable Long-Term Value*

The guidance on Principle 1 would be improved by encouraging more exploration of how stewardship delivers *long-term sustainable value*. At present, there is no reference to this core purpose of stewardship. For instance, the guidance may recommend that signatories articulate what "long-term sustainable value" means to them in the context of their investment styles and the asset classes they are invested in. However, the guidance should go beyond prompting signatories to demonstrate "how their stewardship activities are integral to their allocation, management and oversight of assets" to explicitly exploring how these activities are conducted in the pursuit of sustainable long-term value. This could also be brought out under *Issues, Investment Styles and Asset Classes* – how a pure fixed income investor thinks about long-term sustainable value may differ from how a multi-asset investor considers it.

2. Collaborative engagement, escalation and systems stewardship

We welcome the FRC's more generous approach to collaborative engagement, both here and in the Code. The guidance rightly recognises the importance of collaborative efforts. As importantly, the guidance's call for signatories to explain "their role and contribution" to a collaborative engagement will lead to more valuable insights, especially in the current context of increased scrutiny of ESG-related collaboration and growing investor involvement in policy and regulatory engagement. However, collaborative engagement could be further supported by also noting (p41) that where signatories have chosen *not* to engage collaboratively on priority thematics, effective reporting explains the reason for this approach and measures taken to ensure effective bilateral stewardship.

We encourage the FRC to go further in recognising the role of systems stewardship, including engagement with a broader range of stakeholders beyond investee companies. This is particularly relevant for stewardship in 'other' asset classes (i.e. non-shareholder stewardship), where investors may engage with ecosystem participants such as banks, credit rating agencies, standard-setters, and other industry bodies. We also suggest that the FRC explicitly include contributions to working groups and multi-investor initiatives as valid forms of collaborative engagement. This would help smaller investors feel more confident in participating and reflect the full spectrum of collaborative activity.

On escalation, it would be helpful for the FRC to clarify that the methods for escalation (p42), such as voting, divestment or collaborative engagement, are not inherently escalatory, but fundamental investor rights which *may be used in an escalatory manner*, depending on context. A short addition to this effect would help avoid misinterpretation. Similarly, the guidance could clarify that effective engagement is not limited to meetings with senior executives but should be assessed based on the relevance of the role engaged. And, as with collaborative engagement above, effective reporting should also explain where and why escalation was not pursued despite objectives or milestones not being met.

Finally, engagement activities, escalation and collaboration should be clearly linked back to the signatories' stewardship strategy, underlying objectives, and approach to creating long-term sustainable value. As an example, disclosure of vote rationales should articulate the relevance of the votes to the signatory's broader strategy.

3. Case study framework

The case study framework has been one of the most positively received elements of the guidance. Its structure and comprehensiveness are widely appreciated, and we expect it will support more consistent and insightful reporting across the market. We note that asset owners may encourage asset managers to adopt the template, which could further enhance consistency and comparability.

To strengthen its utility, we recommend that the framework be more explicitly linked to the signatory's broader stewardship and investment strategy. This includes explaining why the case study was selected, how it aligns with key themes, and how it reflects the signatory's overall approach. It would also be helpful to include how the engagement is being tracked and monitored, and how it connects to internal KPIs or real-world outcomes.

Finally, continued emphasis from the FRC that the framework is not prescriptive would be welcomed. It may be helpful for the FRC to provide good practice examples of case studies that do *not* adhere to the framework in its annual reviews.

4. Approach to different asset classes and investment styles

We welcome the guidance's recognition of different investment styles, including index strategies, and the flexibility it offers for stewardship across asset classes. This is a significant improvement on the 2020 Code, which was at times overly prescriptive in areas where practice is still evolving.

Nonetheless, we continue to encourage the FRC to expand its guidance on stewardship in non-listed asset classes and clarify that climate strategies are material to issues for engagement not just in listed equity. At present, p.34 and p.35 suggest that listed equity investors may engage on "capital allocation, shareholder returns, succession planning, external board evaluations, climate strategies, treatment of employees and board and company diversity". All of these may be material in other asset classes too (notwithstanding shareholder returns).

Along these lines, further consideration of the opportunities for other non-shareholder escalation and stewardship would also be welcome. Chiefly, this could include examples of escalation tools relevant to fixed income, real assets, or private equity. It would also be helpful to highlight the unique rights and responsibilities associated with different asset classes, such as engagement opportunities in labelled debt or direct ownership in infrastructure.

The FRC's continued flexibility in this area is essential to support innovation and the development of effective stewardship practices across the full spectrum of asset classes.

5. Resourcing

Guidance on Disclosure B could provide further information on what kind of disclosures on resourcing would be helpful, including headcount, organisational structure, incentives and expertise, as well as an indication of stewardship resourcing relative to overall investment resourcing, in line with the PRI and Thinking Ahead Institute's *Stewardship Resources Assessment Framework*.

Conclusion

The FRC's guidance is a significant and positive step forward. It successfully balances the clarity needed to report meaningfully while preserving the adaptability that is central to the Code's success. The emphasis on narrative-driven reporting, the expanded and more realistic definition of outcomes, and the practical tools provided (most notably, the case study framework) are all welcome developments.

We look forward to seeing how the guidance evolves and encourage the FRC to consider how else stewardship best practices might be supported through and around the Code. This includes the role the FRC can play in highlighting good practice and emerging concerns on an annual basis alongside further investor outreach, through webinars and other forums. Further clarity on the support provided to signatories and plans for continued practitioner input into the guidance would be welcomed.

We look forward to continuing our engagement with the FRC on this important work.