

Consultation response to proposed revisions to the UK Corporate Governance Code

February 2018

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Summary

Insight Investment (Insight) is headquartered in the UK and is a specialist in fixed income and liability driven investment, managing over £584 billion.¹ We invest on behalf of our institutional client base, which includes pension funds, insurers, financial institutions and local authorities. These investments support the UK economy and provide employment and secure pensions for millions of people throughout the country.

We invest in many large listed and non-listed UK, European and international companies. Corporate governance is critical to managing investment risk and we expect corporate issuers to maintain the highest possible standards. Similarly, stewardship is central to accurate credit assessments; companies with strong relationships with bondholders are likely to make better long-term investments.

Insight supports the “comply or explain” framework underpinning UK corporate governance. Insight believes corporate governance standards must be upheld by all institutions, including unquoted companies, to maintain trust in our financial markets and improve the accountability of all large UK businesses. We also believe there are possible improvements to the Stewardship Code that reflect a broad investor base currently undertaking stewardship activities outside equities.

In the consultation response provided below we respond to questions on updates to the UK Corporate Governance Code and potential reforms to the Stewardship Code from our perspective as a large bondholder.

Insight Investment
22 February 2018

¹ As at 31 December 2017. Assets under management (AUM) are represented by the value of cash securities and other economic exposure managed for clients. FX rates as per WM Reuters 4pm spot rates. Reflects the AUM of Insight, the corporate brand for certain companies operated by Insight Investment Management Limited (IIML). Insight includes, among others, Insight Investment Management (Global) Limited (IIMG), Insight Investment International Limited (IIIL), Cutwater Asset Management Corp. (CAMC), Cutwater Investor Services Corp. (CISC) and Insight North America LLC (INA), each of which provides asset management services.

Q1. Do you have any concerns in relation to the proposed Code application date?

It is reasonable to implement the Code by 1 January 2019. However, a staggered implementation for some Provisions would be beneficial if there is a significant increase in disclosure requirements.

Q2. Do you have any comments on the revised Guidance?

There are a significant number of changes to the Guidance but none we consider material. The most significant is removing the smaller company exemption to many Provisions, which we encourage.

We further support enhancing the Guidance document and the questions listed in the document to prompt board and management discussion.

Q3. Do you agree that the proposed methods in Provision 3 are sufficient to achieve meaningful engagement?

The three suggestions outlined in Provision 3 are sensible methods for representing employee voices in the boardroom. They may not be the only options board will want to use and consider companies should find the 'best fit' structures that reflect their individual cultures and corporate structures. In particular, any system employed should work within the UK's unitary board principle and the duties board members owe to their stakeholders. This should be underpinned by a comply-or-explain approach consistent with other areas of the Code.

Q4. Do you consider that we should include more specific reference to the UN SDGs or other NGO principles, either in the Code or in the Guidance?

The challenge in adding NGO principles to the Code or Guidance is there are an abundance of such good initiatives. These initiatives may be global (such as UN Global Compact) or sector-specific (such as EITI in the mining industry). Identifying the most suitable NGO principle to support or benchmark against should be for each company to decide in conjunction with their various stakeholders.

In our extensive experience reviewing company sustainability programmes large companies have already established their social and environment footprints and implemented strategies to manage the risks and opportunities relevant to their businesses. Further guidance would not be value-adding as we find large UK listed companies already provide adequate information on these areas.

However, there could be additional benefits focusing on enhancing sustainability reporting more broadly for unlisted businesses where environment and social disclosure is often weaker.

Q5. Do you agree that 20 per cent is 'significant' and that an update should be published no later than six months after the vote?

We agree that a suitable benchmark for shareholder resolutions is 20%. We also consider six months a reasonable timeframe for a company to meet with and report to shareholders where there is dissent.

Q6. Do you agree with the removal of the exemption for companies below the FTSE 350 to have an independent board evaluation every three years? If not, please provide information relating to the potential costs and other burdens involved.

We believe all large listed and non-listed UK-based businesses should strive for the highest standards of corporate governance. An annual board evaluation is realistic for large businesses although some exemptions should be permissible if reasonable.

Q7. Do you agree that nine years, as applied to non-executive directors and chairs, is an appropriate time period to be considered independent?

Insight believes one of the critical independent tests for non-executive directors and chairs should be their length of service and nine years is an appropriate time-span. In some cases a longer tenure may be more appropriate as part of the overall makeup of the board; in such situations a longer timespan should be explained in full to stakeholders.

Q8. Do you agree that it is not necessary to provide for a maximum period of tenure?

Yes. For large, listed businesses the UK corporate governance framework provides clear guidelines for setting board composition. We believe flexibility is important in setting board tenure.

Q9. Do you agree that the overall changes proposed in Section 3 of revised Code will lead to more action to build diversity in the boardroom, in the executive pipeline and in the company as a whole?

Making boardroom composition and diversity a pillar of UK corporate governance will drive faster improvements in standards. We agree that diversity should be extended within the existing Code. The proposed changes to Section 3 will have a greater impact on an important governance theme (nomination, succession and board composition) that can often attract less focus by senior management, the board and investors.

Q10. Do you agree with extending the Hampton-Alexander recommendation beyond the FTSE 350? If not, please provide information relating to the potential costs and other burdens involved.

We believe all large listed and non-listed UK-based businesses should strive for the highest standards of corporate governance. All large companies should be encouraged to disclose the gender balance on the Executive Committee and their reporting lines. In addition to the annual report company websites should also be used to communicate this information.

Q11. What are your views on encouraging companies to report on levels of ethnicity in executive pipelines? Please provide information relating to the practical implications, potential costs and other burdens involved, and to which companies it should apply.

Boardroom and management diversity is important for strengthening corporate culture and better decision-making. As an investor, we are looking to allocate capital in companies with the strongest possible governance structures, and this includes diversity. However, ethnicity is a poorly-defined characteristic, with many companies not tracking this information for their workforce. Further, while in principle extending the framework is sensible, we have not seen significant academic or government studies exploring the link between (non-gender) diversity and either financial or governance performance. More work needs to be done in this area. We suggest companies start by providing suitable diversity disclosure relevant for their businesses.

Q12. Do you agree with retaining the requirements included in the current Code, even though there is some duplication with the Listing Rules, the Disclosure and Transparency Rules or Companies Act?

Yes, accounting is a cornerstone of corporate governance and this is effectively emphasised by including associated requirements in the Code.

Q13. Do you support the removal to the Guidance of the requirement currently retained in C.3.3 of the current Code? If not, please give reasons.

Yes, the audit committee responsibilities are more clearly outlined.

Q14. Do you agree with the wider remit for the remuneration committee and what are your views on the most effective way to discharge this new responsibility, and how might this operate in practice?

Insight supports extending the remit of the remuneration committee (remco).

We believe remcos should be transparent on how they are considering the interests of the wider workforce in setting and managing remuneration activities, including using external advisors and delegation to other committees. In practice this will likely be an extension of the existing remuneration statement found in the annual report, including why KPIs are/are not used, and disclosure of these figures. This aligns with Provision 40.

Q15. Can you suggest other ways in which the Code could support executive remuneration that drives long-term sustainable performance?

Companies hold regular meetings with shareholders to review remuneration but omit bondholders in these discussions. Bondholders typically have less access with board members on a number of governance issues, especially remuneration, but pay can misalign incentives and therefore be material for bond prices.

As bondholders frequently have long-term investment portfolios, matching the cash and risk profile needs of pension funds in particular, they are particularly interested in managing long-term risks. We believe explicit mention of bondholder dialogue should be included in the Code or Guidance to ensure bondholder interests are taken into consideration when setting remuneration policies and practices.

Q16. Do you think the changes proposed will give meaningful impetus to boards in exercising discretion?

Yes, if the proposed changes should give boards greater discretion in implementing a flexible remuneration policy that is responsive to the individual needs of the company and its workforce.

However, a broader remit combined with more inbound information may be onerous for remco members. We do have some concerns that extending responsibilities and expectations can lead to more tick-boxing and weaker governance oversight in some areas.

Q17. Should the Stewardship Code be more explicit about the expectations of those investing directly or indirectly and those advising them? Would separate codes or enhanced separate guidance for different categories of the investment chain help drive best practice?

The existing Stewardship Code focuses predominantly on the role of shareholders, but for Insight the importance of active stewardship also applies to other invest asset classes, such as bonds, as well as asset owners and service providers.

We do not consider multiple Codes a useful way to promote stewardship in broader investment strategies and across market participants. We believe the existing Code can be amended to more clearly account for differing investment strategies or roles and promote broader stewardship. This could be achieved by extended the use of guideline documents.

Q18. Should the Stewardship Code focus on best practice expectations using a more traditional 'comply or explain' format? If so, are there any areas in which this would not be appropriate? How might we go about determining what best practice is?

We believe it would not suit end-client needs if stewardship rules, structures and targets were formalised. There is a broad church of investors with differing investment styles, including asset classes, time horizons, risk factors and practicalities that will need to be considered. Our reporting and discussion with clients helps ensure we take the right approach to stewardship that meets our end-client needs.

Insight supports both greater explicit guidelines and disclosure-focused question formats as options for enhancing the quality of the Code. Either method will need to be reasonable and consider the nuances of a broad investor base.

Q19. Are there alternative ways in which the FRC could highlight best practice reporting other than the tiering exercise as it was undertaken in 2016?

Best practice reporting is different for every asset class. Most reporting focuses on equities and there are numerous high-quality examples available.

In other asset classes reporting quality is lower and there would be benefits for investors if best practice examples existed. Investors should have the opportunity to report for specific asset classes. This will be a potentially more difficult exercise for the FRC, but the current Tier 1-3 exercise is not especially useful in identifying best practice outside equities.

Q20. Are there elements of the revised UK Corporate Governance Code that we should mirror in the Stewardship Code?

The revised Corporate Governance Code is sufficiently broad and detailed on a range of critical governance themes. This is in contrast to the Stewardship Code, which we identify as much more narrow and focused, yet high-level. This high-level framework should remain given the nuances of investors already outlined in question 18.

As our credit research process always involves an assessment of corporate governance and broader ESG risks, we believe improved accountability of the Code and enhanced disclosure will be beneficial to the credibility of the Code and the usefulness for investor stakeholders.

Q21. How could an investor's role in building a company's long-term success be further encouraged through the Stewardship Code?

We believe the Stewardship Code could enhance companies' long-term performance by:

- Ensuring statements are updated annually
- Quantitative information is provided (such as total number of engagements and their type)
- Audit/assurance of process for stewardship
- Explanation on how senior managers are involved in the stewardship process
- Explanation of how different asset classes are impacted by the stewardship process
- Extending the Stewardship Code to include all relevant asset classes
- Description of the stewardship strategy

Q22. Would it be appropriate to incorporate 'wider stakeholders' into the areas of suggested focus for monitoring and engagement by investors? Should the Stewardship Code more explicitly refer to ESG factors and broader social impact? If so, how should these be integrated and are there any specific areas of focus that should be addressed?

Insight believes investors' first priority must be to serve our client's investment objectives within the parameters of their guidelines. We believe this includes using and integrating ESG factors as part of investment risk and stewardship activities.

However, we do not believe investors have a central role to *create* broader social impact unless explicitly requested by a client. We have a fiduciary and legal obligation to meet the financial needs of our clients, which would be materially impacted if additional objectives were expected. That's partly because the definition of both 'social' and 'impact' are unclear and the investment opportunities are severely limited.

The EU recently undertook a consultation on investors' duties regarding sustainability, and there is a clear overlap with this question. We would advise considering the outcome of the EU consultation, which concluded in January 2018.

Insight's response to the EU consultation: <https://ec.europa.eu/eusurvey/publication/investors-duties-sustainability-2017>

The consultation homepage: https://ec.europa.eu/info/consultations/finance-2017-investors-duties-sustainability_en

Q23. How can the Stewardship Code encourage reporting on the way in which stewardship activities have been carried out? Are there ways in which the FRC or others could encourage this reporting, even if the encouragement falls outside of the Stewardship Code?

Insight extended its response to the Stewardship Code ahead of the tiering exercise in 2016. The enhancement of our disclosure underscores the importance of regulators and third-parties reviewing submissions and expecting higher standards. We believe annual assessments of stewardship activities will enhance the quality and depth of reporting.

Stewardship reporting is often requested by clients; we capture relevant information in our annual report and in responses to industry surveys, such as the PRI. External accountability is partly responsible for increasing our stewardship reporting. The more third-party bodies and stakeholder groups find value in stewardship reporting the more we are likely to disclose. We therefore would examine encouraging investors to report at least annually to one independent body on stewardship/engagement activity.

Despite recommendations from the Law Commission there is limited interest from the majority of Insight's clients in discussing stewardship performance; this accountability gap should be explored with a view to encourage more investor-client dialogue.

Q24. How could the Stewardship Code take account of some investors' wider view of responsible investment?

Insight is a significant investor but we are not shareholders. Our strategies focus on fixed income and cash/liability matching. We cannot vote, therefore have no say on remuneration, business actions and board/executive performance. However, stewardship does not start and end with voting. It is an important part of stewardship but not the only activity. We therefore encourage greater focus of the needs of a broader investor base, especially bondholders.

Insight is large enough to have an impact. We have regular and constructive dialogue with issuers and have helped to improve ESG performance at many of the companies we invest in.

We believe stewardship applies to us as bondholders; we have a responsibility to understand and mitigate ESG and broader risks.

The Stewardship Code focuses on the role of shareholders and reference is made throughout the existing Code to shareholders. However, the principles are much broader and can apply to other asset classes, including real assets. We agree it is more challenging to apply stewardship principles in other areas but this does not and should not mean investors are exempt from applying the stewardship code.

While there is general agreement on what stewardship looks like, there is far less on what 'responsible investment' is. Because there is a wide perspective, with some considering it aligned with ethics and others 'ESG integration', building this into a code may not add value. Further, existing frameworks and reporting methods, most notably the PRI, are a suitable framework and replication would add no benefit. However, Insight is one of a limited number of investors to disclose our response in full on our website. The Code could be expanded to include disclosure of responsible investment activities without prescribing what type of disclosure.

Q25. Are there elements of international stewardship codes that should be included in the Stewardship Code?

The stewardship code needs updating to reflect market needs. We believe that any attempt to update the code must consider all investor types (see response to question 24). Many international codes replicate the UK approach and have a strong focus on equities.

We do consider internal governance structures, as outlined by the ICGN, to be a useful and sensible point of disclosure and a variation of it should be considered for the UK Code.

Regarding stock lending policies, we consider a comply-or-explain approach to be most suitable.

Q26. What role should independent assurance play in revisions to the Stewardship Code? Are there ways in which independent assurance could be made more useful and effective?

Independent assurance of the stewardship code is not currently value-adding to our clients or process. The systems, governance and methods to stewardship are best analysed using internal audit and review processes and we have not undertaken an external review. Further, with best practice guidelines missing for asset classes like fixed income a fair assurance process is lower.

A useful method for enhancing assurance will be to develop guidelines for third-parties. This may help increase the number of bodies providing the service, which we believe is small. We also believe that internal assurance is suitable and should be encouraged if methods are fully disclosed.

Q28: Should board and executive pipeline diversity be included as an explicit expectation of investor engagement?

Insight supports greater inclusion of women on company boards and in executive management. However, investors need to establish the themes and targets for their engagement. They will have to balance considerations such as internal resources, risk exposure, access and existing relationships to name but a few, when deciding on engagement strategies.

If diversity becomes a requirement or expected it risks reducing the engagement focus elsewhere, which may increase other environment, social and governance risks because accountability in these areas may be lower.

We also believe that if this was included in the Code investors would end up duplicating their activities, which is inefficient and likely to increase free-riding.

Q29: Should the Stewardship Code explicitly request that investors give consideration to company performance and reporting on adapting to climate change?

Insight reviews environment performance for all issuers as part of its fundamental assessment of a credit. We believe understanding the full range of risks, including climate change, gives more assurance over the short and long-term credit opportunities and risks.

Climate risks vary by industry, issuer and country. There are challenges in using environment information and we therefore urge caution in setting guidelines that explicitly request investors to consider climate change. We believe investors should outline how they consider climate change factors in their investment and stewardship activities. But we do not consider prescriptive rules a useful addition to the Code. Similar to question 28, we believe investors need to define and integrate the risk factors relevant to their investment processes and strategies.

Q30: Should signatories to the Stewardship Code define the purpose of stewardship with respect to the role of their organisation and specific investment or other activities?

Yes, this is compatible with our emphasis on making the stewardship more suitable for a broader range of investors, such as bondholders. Stewardship for equity investors will not be identical for bondholders, although there is some overlap.

Q31: Should the Stewardship Code require asset managers to disclose a fund's purpose and its specific approach to stewardship, and report against these approaches at a fund level? How might this best be achieved?

This would not be practical for a large investor like Insight managing multiple funds across different asset classes. This disclosure requirement would be significant and weaken the quality of disclosure, therefore the value to stakeholders is likely to be limited.

However, for funds that have a self-described ESG label, and the number of such funds is increasing fast, there should be a higher standard of disclosure. It is realistic to expect such funds to disclose how ESG factors apply to the fund level. Fund stewardship information could also be disclosed alongside the ESG information.

Contact page

Email ri@insightinvestment.com
Address 160 Queen Victoria Street,
London EC4V 4LA



www.insightinvestment.com



[@insightinvestim](https://twitter.com/insightinvestim)



[company/insight-investment](https://www.linkedin.com/company/insight-investment)

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