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To the Business Frameworks Directorate

Department for Business, Energy and Industrial Strategy Consultation: Insolvency and Corporate Governance

The International Corporate Governance Network (ICGN) is pleased to respond to the Department for Business, Energy and Industrial Strategy (BEIS) Consultation on Insolvency and Corporate Governance.

Led by investors responsible for assets under management in excess of US$34 trillion, ICGN is a leading authority on global standards of corporate governance and investor stewardship. Our membership is based in more than 45 countries and includes companies, advisors and other stakeholders. ICGN's mission is to promote high standards of professionalism in governance for investors and companies alike in their mutual pursuit of long-term value creation contributing to sustainable economies world-wide. Our policy positions are guided by the ICGN Global Governance Principles and the ICGN Global Stewardship Principles, both of which have been developed in consultation with ICGN Members and as part of a wider peer review. For more information on ICGN please see: www.icgn.org

Though ICGN's membership and geographic purview is global in scope we are active in the debate around UK corporate governance and investor stewardship, and contribute regularly to consultations relating to UK governance matters.[1]

Consultation: Insolvency and Corporate Governance

The BEIS consultation is broad in scope, and focuses on a range of specific issues, some of which ICGN is not well-positioned to comment on. However we are

[1] For example, please see:

- ICGN's February 2018 response to the Financial Reporting Council's consultation to the UK Corporate Governance Code: https://www.icgn.org/sites/default/files/4.%20ICGN%20Comment%20FRC%20UK%20Corporate%20Governance%20Code%20Consultation%20Feb%202018_0.pdf
- ICGN's February 2017 response to the BEIS consultation on the UK Green Paper for Corporate Governance Reform: https://www.icgn.org/sites/default/files/ICGN%20response%20UK%20Green%20Paper%20on%20Corporate%20Governance%20Reform.pdf

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supportive of the fundamental aims of this consultation, particularly to reduce the risk of major company failures where shortcomings in governance and stewardship may be a problem. In this context the consultation's section on Strengthening Corporate Governance in Pre-Insolvency situations is most relevant for our comment, in particular the section on shareholder responsibilities and the consultation question 12 relating to investor stewardship.

Before turning to that issue, ICGN makes the following high-level comment on the first section of the consultation: the proposal for a new obligation on the directors of holding companies (questions 1 to 4). The consultation paper does not include a body of supporting evidence for why such a change is needed. Clearly, there have been two particularly newsworthy corporate collapses (BHS and Carillion) which have drawn attention to corporate and insolvency law. However, ICGN believes it is very important that a change of this nature should not be made without clear evidence, and a proper cost / benefit analysis, given that the type of change being considered would materially modify a core principle of UK company law: that directors owe their duties to the company on whose board they sit.

In relation to the issue of investor stewardship, we appreciate that BEIS is interested in how shareholders may be in a position to support BEIS' industrial strategy to improve productivity in the UK. We are supportive of that strategy and would agree that good investor stewardship can complement or contribute to the achievement of these policy outcomes. But we also emphasise that the fundamental fiduciary duty of institutional investors is to their beneficiaries — the pension fund members and other long-term savers. The same duty applies to asset managers to whom institutional investors will often delegate their stewardship obligations. In this context investor engagement will focus on promoting long-term company success and sustainable value creation in the companies in which it invests. While this might harmonise with the government's own policy ambitions relating to productivity and growth, we would strongly emphasise that investor stewardship in the first instance is focused on fulfilling their obligations to investor beneficiaries and is not a tool of, or substitute for, the UK government industrial policy.

From our global perspective we recognise the UK market as one of the world leaders in investor stewardship. This reflects a strong institutional and regulatory framework, including the strong foundations of the UK Corporate Governance and Stewardship Codes, investor associations such as the Investor Forum and Investor Association. Importantly, this also involves a strong tradition of historical cooperation between investors and companies—as well as investor willingness to take part in collective engagement (in ways that do not break Takeover Code thresholds). Regulators and policymakers around the world are studying the UK's progress in stewardship, often seeking to replicate the UK's general framework and institutions. So we are working from a positive base, and encourage you to recognise the UK's comparative advantage in this domain—even as you seek to bring about continued improvement in the UK.

We would suggest that your description of the stewardship environment and resource base in the UK is a bit limited in scope, and may not do justice to the significant level of engagement and stewardship activity taking place in the individual institutions,

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both in the UK and overseas. You rightly cite the Investor Forum and Investor Association as investor bodies providing a useful service to both the investor and corporate community by enabling and facilitating engagement with the investment community. In addition to those two bodies there is also an even less formalised "Corporate Governance Forum", which provides a regular forum for dialogue among stewardship professionals in different institutions (both in and out of the UK), including a regular weekly conference call during voting season to discuss AGM related governance issues and votes.

These are all positive initiatives. But in fact the actual level of engagement in the UK, though perhaps difficult to measure precisely, goes much further beyond the 10-14 companies reviewed by the Investor Forum that your consultation paper describes. Many asset managers and owners, from both the UK and overseas, engage with companies throughout the year on a regular basis, independently from the good work of the Investor Forum and the Investor Association. But at the same time you also rightly question as to whether more can meaningfully be done to make robust stewardship a reality towards improving corporate outcomes. Notwithstanding the many strengths of the UK system, we also recognise that there will inevitably be scope for improvement. And reflecting the Financial Reporting Council (FRC) recent tiering system for Stewardship Code signatories it is clear that the implementation of stewardship practices is at times imperfect and inconsistent among the signatories.

In this regard we welcome the upcoming review of the UK Stewardship Code, which should allow for further refinements as the profession of investor stewardship builds. We also believe that perhaps the best answer to the questions you raise about improving stewardship is to give the soon-to-be-updated Stewardship Code time and ongoing support/patience to work into the culture of investment management. As the FRC observed in its 2015 report, after five years' experience with the Stewardship Code, a "culture of stewardship" takes time to develop.

But to encourage and promote more effective investor stewardship—which can complement the government's industrial strategy—we offer some specific suggestions below, which we are likely to reiterate when we respond to the UK Stewardship Code consultation later this year:

- **Evidence base.** Establishing a robust evidence base relating to stewardship activities can help to build the "business case" for stewardship and provide incentives for investors to invest in appropriate resources to undertake stewardship at an appropriate level of professionalism and rigour. Evidence may also shed light on which tactics or stewardship strategies may be most – or least – effective. In this context, BEIS may wish to contribute to the knowledge pool relating to investor stewardship by sponsoring or mandating a research project (or projects) conducted by academics and/or professional researchers to help build understanding of stewardship with a stronger foundation of evidence.

- **Model mandate**. You may wish to consider recommending (but not requiring) that institutional investors make use of model contract language to ensure that stewardship practices are included as features of standard investment

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management mandates. ICGN's Model Mandate Guidance has been used in varying jurisdictions globally as a means to incentivise stewardship into the investment management process.[2] The upcoming revision of the UK Stewardship Code may provide an opportunity to consider if some standardisation of mandate language relating to stewardship will support and improve the scope and quality of stewardship practices.

- **Capital allocation.** BEIS rightly identifies capital allocation in the consultation document as one aspect of consideration for investors with regard to stewardship. Misallocation of capital can be one of the contributors to corporate failures and insolvencies, and we do not believe that it is as visible in the corporate governance debate as it should be. In our response to the FRC's recent Corporate Governance Code consultation we highlighted capital allocation as a possible a missing item. There is a clear corporate governance dimension to capital allocation; however the Code is silent on this topic. We also noted that BEIS is conducting a review of share buybacks as a possible mechanism for executives to inflate their own pay.

  We suggested that the FRC may wish to consider incorporating the issue of capital allocation more explicitly into the new Code it is developing—if nothing else to call for companies to disclose their buyback and capital allocation policies as part of their annual reporting practices. From a stewardship dimension, it is also relevant for shareholders and creditors to feature buybacks-- and capital allocation more broadly-- as topics for engagement with both company executives and non-executive directors. In particular, shareholders with voting rights should be prepared to use these rights to vote against buyback transactions that may have the effect of asymmetrical rewards to company managers at the expense of other investors and the company's own long-term financial health. We believe this topic could also feature in the FRC's forthcoming review of the UK Stewardship Code.

- **ICGN Global Stewardship Principles.** We were pleased that the recent FRC consultation paper on the UK Corporate Governance Code also touched on investor stewardship and recognised ICGN's own Global Stewardship Principles (GSP) – which share many similarities with the UK Stewardship Code, but also with some differences. In this regard we would like to raise to you two specific points where the FRC's forthcoming review of the UK Stewardship Code might benefit from ICGN's GSP.

  Firstly, to a greater extent than the UK Code, the ICGN GSP prioritises the internal governance arrangements of investors themselves as a driving principle of stewardship, and we believe that investor governance could be more robustly reflected in the revised UK Stewardship Code.

  Second, we would also encourage the UK Stewardship Code to more explicitly articulate the importance of ESG integration as a component of good

[2] See ICGN Model Mandate: http://icgn.flpbks.com/icgn_model-contract-terms_2015/#p=1

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stewardship; this is at the core of one of ICGN's seven stewardship Principles. We believe that more active integration of ESG factors in the stewardship and engagement process can help to identify long term risks and risk mitigants that should support the sustainable value creation of companies and greater sustainability of financial markets as a whole.

In conclusion, ICGN supports the initiative of BEIS in this consultation, and we hope that our feedback and comments are helpful in your deliberations. Should you wish to discuss our comments further, please contact me or George Dallas, ICGN's Policy Director, by email at george.dallas@icgn.org.

Yours faithfully,

Kerrie Waring,
Executive Director, ICGN