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RESPONSE TO
Consultation on Building a Regulatory Framework for Effective Stewardship

Where: "Stewardship is the responsible allocation and management of capital across the institutional investment community to create sustainable value for beneficiaries, the economy and society", FRC, 2019

Mainstream responses such as BlackRock's 2019 'Letter to CEOs' et al, suggest awareness, goodwill & leadership are no longer the major issue.

We suggest: The ability to reliably engage future-value-creation and future-risk within decision making and communication remains as the major systemic constraining issue

"Stewardship activities include monitoring assets and service providers, engaging issuers and holding them to account on material issues, and publicly reporting on the outcomes of these activities", FRC, 2019

New Thinking: The Institute of Performance Sciences develops and promotes breakthrough new practice for engaging long-term capital with sustained high-performance value-creation… inside companies, funds and across capital markets.

We propose: We call on FRC, FCA and its community to participate in convening UK and global collaborations to mature, test, develop and disseminate breakthrough 'Governance of Value Creation' practices.

Executive Summary

We would like to bring a research breakthrough, and growing collaborative response, to your attention. We recommend its potential to provide material contribution to stewardship and other outcomes.

Our work provides a unique basis for costing of future-risk (financial and non-financial), complimenting various existing global initiatives in measurement and principles. It enables systemic inclusion of the broader range of 'next generation' issues within capital allocation, investment strategies and differentiated public investment-product disclosures.

Preliminary research evidence supporting this new approach can only be matured to effective industry practice through collaboratively engaged cross-industry initiatives; in the style of FCLT, Embankment Project, IIRC, et al.

Breakthrough practice alone does not produce systemic change. We call on relevant parties to actively participate in a convening an appropriate collective response.

Technical Background

Our academic and commercial research has engaged over 100 of Australia's most senior economic leaders including directors at each of the ASX10 (7 at Chair), and their equivalents within asset owners and fiduciaries, Departments, agencies, regulators and Executive Government – and many of their global counterparts.

Our work identifies the basis of a new approach for assuring "the long-term sustainable success of the company, generating value for shareholders and contributing to wider society"[1]; in a context where "boards are increasingly being called upon to address new or emerging issues including around culture, conduct risk, digital disruption, cyber-security, sustainability and climate change"[2].

We have developed models and preliminary evidence of a material link between governance and sustained performance.

'Governance of Value Creation' is an integrated multi-disciplinary model for sustained value-creation in large scale organisations. It has been recognised as the 'how to achieve *Integrated Thinking*'. And, it has been described as the 21st Century Decision Making alongside IIRC's 21st Century Reporting to address A4S's 21st Century Challenges.

- **For companies**, this enables leaders to address the Future Fiduciary question, "how can I ASSURE that we are 'optimally invested in our own future?'". How do you optimise across IIRC's 6 capitals, or SDGs, or social outcome measures across multiple timelines - within increasingly complex and uncertain contexts. Preliminary research demonstrates a link to sustained out-performance - with the leading practitioner in our research performing 500% ahead of the index over 10 years.

- **For investors,** the related 'Value Creation Maturity Assessment' provides the basis for a costing of future-risk that could be expanded to a globally scalable disclosure framework. It provides a mechanism of assessing the level of certainty associated with an organisation's future prospects. It is a knowledge economy, intangible value and social outcome equivalent to the JORC / SAMREC / SME codes used to disclose certainty of asset value / future prospects in the global resources sectors. Our work parallels the relationship between financial disclosure and audit.

Our approach enables periodic oversight of the net future performance of complex portfolios – extending the Future Fiduciary ability to:

- stewardship and the stakeholders of this review, and
- effective and assurable communication with regulators and the public

Application

A company's value is based on risk and uncertainty-mitigated future projections in a context where the past is an increasingly poor indicator of future performance. Financial accounts alone are insufficient to assess a company's value, and past performance tells nothing of future achievement of non-financial indicators.

Point-in-time measures (in a company or across a portfolio) have little public meaning (e.g. tonnes of carbon, litres of water, ??? social outcome values, SDG measures, etc.). Periodic reporting of reliable future 'value' indicators a) makes investment decisions possible, and b) carries significant public and consumer relevance.

[1] FRC's UK Corporate Governance Code, 2018
[2] ASX Corporate Governance Council's Corporate Governance Principles and Recommendations, edition 4

Our work brings material impact to the ability to invest in, manage portfolios and communicate financial products that involve non-financial outcomes.

Knowledge to Impact Precedent

The Institute's new knowledge in Governance of Value Creation, and the associated Value Creation Maturity Assessment can be seen as a future-oriented analogue to Financial Governance and Audit. Many framework specialists acknowledge the influential context of this new knowledge… but it is a little hard to grasp for a 'secular' audience.

A more obvious precedent is demonstrated by the JORC code.

The JORC code was developed in Australia as a response to the Poseidon nickel boom and resulting stock market crash in the 1960s.

The Australasian Joint Ore Reserves Committee (JORC) developed standardised reporting on the levels of certainty associated with extracting value from Mining and Resource assets. It is an 'accounting for' the extent and results of scientific testing of geophysics and geochemistry that is now enforced by ASIC and the ASX as part of resource sector listing rules. It has been duplicated in similar disclosure regimes in a dozen jurisdictions across the world, and is now subject to global harmonisation efforts.

It has been suggested that the JORC code is in large part responsible for the fact that near 50% of the Australian Stock Exchange is now represented by mining and resource sector stocks. JORC made mining investible, by enabling risk to be costed. They are not necessarily all 'good investments', but the prospective investor is able to make a judgement based on assurable consistent information.

The Institute of Performance Sciences promotes a cross-sector, knowledge economy, societal-value, intangible-value-creation equivalent to JORC; providing periodic demonstration of the level of certainty associated with an organisation's future prospects. It provides a globally-scalable costing of future-risk suitable for engaging long-term capital with sustained high-performance value-creation (inside companies, across investment portfolios and across capital markets) in a new era of a complex, volatile, global economy.

Our work will contribute to making long-term, environmentally sustainable, stakeholder-engaged business a) visible, and b) investible. It is a capability-lifting market-mechanism that directly answers the written calls from FRC, BlackRock and many others for these behaviours.

Systemic behaviour change through collaboration

Preliminary work can only be developed to systemic impact through collaborative cross-industry participation:

- The **Global Institute of Performance Sciences** (www.ipsglobal.online) seeks to engage global investors in collaboration on improved practice (see Letter to Fiduciaries) engaging long-term capital with sustained high-performance value-creation - inside companies, funds and across capital markets.
- The **Australian Institute of Performance Sciences** (www.aips.online) seeks to 'move the needle' on effective long-term value creation performance in the top500 (focus on top50 = 50% of GDP) participants in the Australian economy made up of large corporates, government jurisdictions and large-scale investors. The Australian component serves as a pilot of systemic uptake of enhanced practice in a G20 economy.

We seek your participation in convening these forums.

The assurable 'accounting for future value' practices we have identified to you in this response address the missing-link between increasingly healthy systemic awareness and stubbornly weak systemic action.

Collaborative development and dissemination of enhanced practice will serve to engage long-term capital with sustained high-performance (financial and non-financial) value-creation - inside companies, funds, across capital markets, and across government and community networks.

Furthermore, it will enable better communication of the value and value creation effects of stewardship to the general public.

Next Steps

Our work provides new perspectives that open up significant new pathways for action.

Please contact us to explore the most appropriate way to work together to advance common objectives.

Many thanks, yours,

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Q1: Do you agree with the definition of stewardship set out here? If not, what alternative definition would you suggest?

Yes.

Q2: Are there any particular areas which you consider that investors' effective stewardship should focus on to help improve outcomes for the benefit of beneficiaries, the economy and society (e.g. ESG outcomes, innovative R&D, sustainability in operations, executive pay)?

We suggest that the effective stewardship requires the capacity to be able to assure, and quantify the quality-based-certainty of a wide range of new and emerging issues. Practices to support this capacity are being developed by our Institute.

It is suggested that there is significant further change in public expectations ahead. This will result from a backlog of unmet challenges, heightened public expectation, online communication, activist behaviours, and a wide range of political, economic, social and environmental uncertainties.

We already see companies and investors struggling to engage and prioritise within the variety of measures and frameworks being thrown their way. None of the emerging frameworks yet has the (still imperfect) maturity, stability and adaptability of financial accounting and audit; we are in the early days. There will be considerable change ahead. And, we expect that there are many more frameworks to come to engage with further issues that have not yet been significantly explored.

The Institute of Performance Sciences has done some early work on a framework superstructure that enables quantified reporting on the certainty of assurance against different framework / measurement options associated with engagement with different issues. Early indicators are that this:

- will show where a company is on its journey to assurance of different classes of outcomes,
- will allow investors to determine and communicate where they (and the clients of their various differentiated investment products) see value, and how their portfolio is tracking against aspiration,
- will allow contractual arrangements with funds managers based on the assurable future-roadmap of portfolio outcomes,
- will allow transparency, sufficiency and assurability of stewardship activities regardless of investment product outcomes, investment strategy, priorities or objectives.

Q3: To what extent do the proposed key attributes capture what constitutes effective stewardship? Which attributes do you consider to be most important? Are there other attributes that we should consider? If so, please describe.

We suggest the proposed key attributes are a step forward from current guidelines, but are not sufficient to address the issues.

We recommend broad collaborative work on a more advanced model that may educate improved guidance at a later date.

Q4: What do you think is the appropriate institutional, geographical and asset class scope of stewardship? How can challenges associated with issues such as the coordination of stewardship activities across asset classes, or the exercise of effective stewardship across borders, be overcome?

See above.

1. Public expectation has not settled. There is more change ahead.
2. Our Institute is working on more advanced models to allow systemic capacity to respond appropriately – but this requires collaborative participation from investors and others.

Q5: We welcome examples of how firms with different objectives and investment strategies approach stewardship. In particular, we welcome input on how stewardship practices differ across active and index-tracker funds, in the following areas: i: how firms prioritise and conduct stewardship engagements ii: what investments firms have made in stewardship resources iii: how stewardship activity is integrated with investment decisions.

No comment. Except a note that our approach may be applicable to index-tracker funds as well as other investment approaches.

Q6: To what extent do you agree with the key barriers to achieving effective stewardship identified in this DP? What do you believe are the most significant challenges in achieving effective stewardship? We would particularly welcome views on the investment required to embed effective stewardship in investment decision-making. 38 DP19/1 Annex 1 Financial Conduct Authority/Financial Reporting Council Building a regulatory framework for effective stewardship

The key barriers identified are accurate, but do not provide a 'framing' of the problem that can be utilised to determine a sufficient solution. It has been our Institute's findings that an alternative perspective and approach is required, and that a new perspective gives rise to new pathways for action.

One example of such reframing is the observation from our preliminary research that using **the practices required for engaging sufficiently with the systemic challenge leads to materially increased and sustained performance**.

As we are able to expand and socialise our preliminary evidence to a suitable standard, the question becomes not "What investment is required to embed effective stewardship", but "At what point is my Fiduciary Responsibility compromised by not implementing practices that are shown to lead to better performance".

Q7: To what extent do you consider that the proposed balance between regulatory rules and the Stewardship Code will raise stewardship standards and encourage a market for effective stewardship?

We would suggest that the proposed action is necessary but not sufficient.

Q8: To what extent are there are issues with proxy advisers that are not adequately addressed by SRD II and proposed revisions to the Stewardship Code?

No comment. Except a note that the quantified and transparent evidence based approach we are developing reframes the role of proxy advisors and others across the system.

Q9: We welcome feedback on other specific aspects of the regulatory framework described above. In particular, we are interested in views on: i: Whether and to what extent the FCA's proposed rules for asset owners should be extended to SIPP operators? ii: The case for regulatory rules to expand the reach of stewardship beyond listed equity iii: Whether there is a role for UK regulators in encouraging overseas investors to engage in stewardship for their asset holdings in the UK iv: The extent to which additional rules might be necessary either to improve stewardship quality or prevent behaviours that might not be conducive to effective stewardship v: For differences between active and index-tracker strategies in the practice of stewardship, whether there are particular regulatory actions we should consider to address any perceived harms. vi: Whether the FCA's proposed rules to implement certain provisions of SRD II should apply on a mandatory, rather than 'comply or explain', basis.

No comment. Except a note that our proposed approach is a knowledge-based and performance-based approach to improve existing practice. It is expected that it will have impact across all of the asset classes and investment domains identified in this question. We recommend that regulation alone cannot solve this issue. Whilst enhanced regulation is necessary it is not sufficient.

Q10: We welcome feedback on whether, to support effective stewardship, we should consider amendments to other aspects of the regulatory framework that affect how investors and issuers interact (such as the LRs, PRs and DTRs)?

No comment.