

THE
INVESTMENT
ASSOCIATION

PENSIONS AND
LIFETIME SAVINGS
ASSOCIATION

INVESTMENT RELATIONSHIPS FOR SUSTAINABLE VALUE CREATION:

ALIGNMENT BETWEEN ASSET OWNERS
AND INVESTMENT MANAGERS

June 2022



ABOUT THE INVESTMENT ASSOCIATION (IA):

The IA champions UK investment management, supporting British savers, investors and businesses. Our 270 members manage £9.4 trillion of assets and the investment management industry supports 114,000 jobs across the UK.

Our mission is to make investment better. Better for clients, so they achieve their financial goals. Better for companies, so they get the capital they need to grow. And better for the economy, so everyone prospers.

Our purpose is to ensure investment managers are in the best possible position to:

- Build people's resilience to financial adversity
- Help people achieve their financial aspirations
- Enable people to maintain a decent standard of living as they grow older
- Contribute to economic growth through the efficient allocation of capital

The money our members manage is in a wide variety of investment vehicles including authorised investment funds, pension funds and stocks and shares ISAs.

The UK is the second largest investment management centre in the world, after the US and manages over a third (37%) of all assets managed in Europe.

ABOUT PLSA:

The Pensions and Lifetime Savings Association is the voice of workplace pensions and savings. We represent pension schemes that together provide a retirement income to more than 30 million savers in the UK and invest more than £1.3 trillion in the UK and abroad. Our members also include asset managers, consultants, law firms, fintechs, and others who play an influential role in people's financial futures.

We aim to help everyone achieve a better income in retirement.

FOREWORD

FROM RICHARD BUTCHER AND ARCHIE STRUTHERS

AT THE START OF 2021, WE ESTABLISHED THIS STEERING GROUP TO DEVELOP RECOMMENDATIONS ON HOW STEWARDSHIP AND THEREFORE SUSTAINABLE VALUE CREATION COULD BE BETTER EMBEDDED INTO THE RELATIONSHIP BETWEEN ASSET OWNERS AND INVESTMENT MANAGERS. WE BELIEVE THAT BETTER INCORPORATING EXPECTATIONS ON STEWARDSHIP INTO THE RELATIONSHIP WILL PRODUCE BETTER OUTCOMES FOR ALL THE PARTIES AND IS FUNDAMENTAL TO IMPROVING THE END-TO-END INVESTMENT PROCESS.

Addressing these issues, of coherent alignment and integration of stewardship, is important because the delivery of appropriate returns for savers is dependent on it. It's also consistent with the increasing expectations of savers on how their money is being managed.

This report, and the recommendations made within it, would not have been possible without the collective efforts of the members of our steering group, who each gave a considerable amount of time to share their expertise and knowledge. All the members, who represented every part of the investment chain, from investment managers, pension funds, consultants, lawyers and regulators, contributed to identifying the barriers to promoting sustainable value creation right across the investment process, and brought a constructively challenging and collaborative approach to developing solutions and stimulating change. We hope that the genuine spirit of collaboration demonstrated by the steering group serves as an example to all. We believe that all stakeholders can, by 'leaning in' and sharing views and perspectives from right across the investment process, ensure that the investment industry develops solutions that can improve the system to the benefit of the end saver and broader society.

We found there are no simple solutions and given current entrenched approaches, delivering on the recommendations will require commitment from all parties across the investment chain. All stakeholders need to take steps to increase the dynamic and aligned nature of the relationship. We have been conscious throughout that there is no single type of asset owner or investment manager, and so have been keen to develop recommendations which are broadly relevant. Our key message is that every organisation needs to play their part and help to deliver change. We all need to take the next step to addressing these issues and encourage all to do the best they can to create a culture for change.

Finally, we would like to thank the IA and PLSA for their valuable support in assisting the steering group. In particular, we would like to express our gratitude to Sarah Woodfield and Andrew Ninian, without whose drive and commitment we would not have been able to deliver this report and its recommendations.

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With thanks to the Steering Group:

- Richard Butcher, Co-Chair of the Steering group
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EXECUTIVE SUMMARY

The Asset Management Taskforce Report, 'Investing with Purpose: Placing Stewardship at the Heart of Sustainable Growth', challenged the investment industry to put the interests of clients and savers at the heart of stewardship. The relationship between asset owners and investment managers sets the tone for sustainable value creation right across the investment chain. Several stakeholders have expressed concern that these relationships are not working as effectively as they could to promote and incentivise the alignment of stewardship and long-term sustainable investment behaviours.

In response to these concerns, the Investment Association (IA) and Pensions and Lifetime Savings Association (PLSA) were asked by the Asset Management Taskforce to bring together the pensions and investments industries towards a common goal. The IA and PLSA set up a joint steering group in 2021, which was tasked with finding solutions for how the relationship between asset owners and investment managers could be governed in a way that promotes a long-term focus and aligns stewardship expectations. It also considered the behaviours and actions that both asset owners, investment managers and their advisors should undertake, with collective responsibility, to improve this alignment in their relationships.

What is a Long-Term Relationships?

Throughout this report, we consider the long-term nature of relationships. The investment time horizons of pension scheme beneficiaries typically necessitates a long-term approach to investment. But the length of the relationship should be aligned with the requirements to meet the investment objectives of the individual fund, which will enable both parties to focus on effective stewardship for sustainable value creation.

It is clear, there is no silver bullet solution. All parties need to step up to a minimum standard to support more sustainable investment relationships. A consistent effort to improve this focus is needed by all parties, we have provided specific recommendations for asset owners, investment managers, investment

consultants and other service providers. This report sets out key considerations to support this focus at each stage of the relationship:

- pre-appointment (the development of stewardship policies and clarification of expectations);
- the manager selection and appointment process; and
- the contractual relationship that underpins the relationship and
- ongoing oversight (including dialogue and performance assessment).

Whilst we have developed recommendations which are asset-class agnostic they should be considered in the context of different asset classes and investment strategies. Recognising the diversity of asset owners and investment managers operating in the UK market with differing investment objectives, business models and governance structures, it is clear there is no one size fits all solution. The recommendations can be adopted and adapted to suit varying needs in different investment relationships and shouldn't be seen as prescriptive guidance. Nevertheless, there is a clear underlying message that all parties do need to reach a minimum standard to support more sustainable investment relationships.

RECOMMENDATIONS FOR PRE-APPOINTMENT OF MANAGER

Asset owners should clarify and clearly articulate stewardship policies which cover the whole investment process, including the different asset classes in which they invest; consistent with their investment strategy and investment delegation approach. When choosing their investment delegation approach, asset owners should assess their resources, expertise and governance capacity to make effective decisions on investment and stewardship activities to promote long-term sustainable value and meet beneficiaries' investment objectives. There should be clear governance and resources in place to support these policies and ensure they evolve these policies over time, to remain focused on sustainable value. This will enable asset owners to enter a manager appointment process with clear expectations on the approach to stewardship and assess which investment managers, products or mandates will meet these expectations.

RECOMMENDATIONS ON MANAGER SELECTION AND APPOINTMENT PROCESS

Investment Managers

Investment managers should share fund or mandate level information about their stewardship approach and how it supports their investment strategy. This should include the Stewardship policies and approaches for the firm and the specific fund, so that asset owners can fully understand the manager's stewardship approach. This will support prospective clients to make an informed decision on whether the fund meets their needs and beneficiaries' priorities. They should also share clear information about how they will facilitate client voice on stewardship matters and how they will facilitate a collaborative relationship with clients focused on sustainable value.

Asset Owners

Asset owners should embed a focus on sustainable value in the manager appointment process by:

- Assessing and monitoring culture and values alignment and how this will support a focus on sustainable value
- Placing greater value on stewardship alignment in the selection criteria and ultimate decision
- Assessing the incorporation of stewardship in the whole investment process across different asset classes and strategies
- Assessing managers capacity to meet evolving expectations and best practice as part of a commitment to a long-term relationship.

Investment Consultants

Investment consultants should support this process by committing to scrutinise the stewardship capabilities of investment managers when supporting asset owners with their selection process and filtering prospective product choices. This should include an assessment of the integration of stewardship into the investment process and across different asset classes and strategies. They should also work closely with asset owners to identify the culture and values that will enable them to work with their managers as part of a commitment to a long-term relationship. Investment consultants should also demonstrate their commitment to incorporate stewardship and long-term investment into the relationships of their clients and investment managers by demonstrating their alignment to the Stewardship Code by becoming signatories.

RECOMMENDATIONS ON DOCUMENTATION THAT UNDERPINS THE RELATIONSHIP

Asset owners and investment managers should establish a 'governing charter' which sets out mutual expectations to prioritise and incentivise a focus on long-term, sustainable value. Investment consultants should commit to supporting the charter. This charter should cover mutual expectations on the promotion of long-term, sustainable value through:

- The expected minimum duration of the relationship;
- Performance reviews;
- Ongoing dialogue, communication and disclosures, including how to facilitate client voice;
- Responsibilities to the market and management of systemic risks;
- Culture and governance; and
- Ongoing alignment of stewardship policies.

RECOMMENDATIONS ON OVERSIGHT AND ONGOING MONITORING

Asset owners and investment managers should agree an oversight framework focused on long-term sustainable value, which aligns the performance review cycle, investment and stewardship objectives, and Key Performance Indicators (KPIs). This should include both quantitative and qualitative reporting items which enable a holistic view of the role of how stewardship supports the investment objectives, throughout the investment process and across different asset classes, and how stewardship activities have contributed to stewardship outcomes.

Ongoing dialogue should enable both parties to communicate evolving expectations on stewardship best practice, facilitate client voice and identify opportunities for collaboration.

Managers should proactively consult their clients on their stewardship policies and expectations, at onboarding and on an ongoing basis. More frequent consultation with clients on their evolving preferences will help facilitate better alignment between clients and managers on their stewardship expectations and will support managers to respond to emerging expectations on best practice.

Running throughout these recommendations are four overriding principles:

1. Asset owners and investment managers should embed stewardship in every aspect of their relationship and ensure this is borne out through a culture and commitment to prioritise sustainable value creation.

We consider the role of stewardship throughout the whole investment cycle including:

- Development of investment beliefs and objectives
- Transparency of how stewardship is embedded into the investment process
- Allocation of capital across investment mandates and across different asset classes and investment strategies – appointment and selection
- The contractual relationship
- The investment process – making investment choices; engagement and exercising rights and responsibilities
- Oversight -ongoing dialogue and performance assessment

2. Asset owners and investment managers should build collaborative long-term relationships that can evolve in response to a changing external environment and emerging best practice. This collaborative approach is key to addressing market wide and systemic risks including sustainability challenges.

The investment time horizons of pension scheme beneficiaries typically necessitates a long-term approach to investment. Long-term relationships, aligned to meet the investment objectives, enable both parties to focus on effective stewardship for sustainable value creation. Stewardship best practice will naturally evolve over time. It is essential

for both parties to have a framework for dynamic and transparent dialogue and communication of expectations. Collaboration across the investment chain is needed to effectively address myriad sustainability challenges and market wide risks. This is a shift away from a one-directional and transactional style of relationship.

3. Both asset owners and investment managers should leverage key 'best practice' behaviours from the UK Stewardship Code.

As the marker of best practice stewardship, the steering group fully support the UK Stewardship Code and encourages more signatories to the Code. Increasing the number of asset owner signatories to the Code will help to ensure that there is more demand for effective stewardship and an increasing number of asset manager signatories will help to meet that

demand. Throughout this report, we cross reference Stewardship Code principles to highlight areas that reinforce the expectations of the Code. By exploring how stewardship can be embedded into investment relationships, the recommendations in this report may support Code reporting for prospective signatories.

4. The recommendations can be taken forward by asset owners and investment managers with different business models and asset owners with different resources and capabilities.

Considering the structure of the UK institutional market, we have thought about different solutions which meet the needs of asset owners and investment managers with different resources and capabilities. For example, smaller asset owners may have limited governance time and resource to dedicate to very detailed oversight of their managers stewardship activities and will be reliant in part on their advisers to support them with their oversight responsibilities. A key focus for such owners should be on ensuring their stewardship expectations are articulated clearly in the investment selection process, seeking alignment at the outset of the investment relationship and working with their advisers to develop a proportionate approach to ongoing oversight.

Investment managers should be more proactive about engaging with their clients on their stewardship priorities and developing products and services to meet demand for effective stewardship. Key to this is a commitment to facilitating 'client voice' in the

development of their products and services and in the ongoing management of their funds. Technological solutions to better facilitate client voice are an important area for the industry to invest – and last year's report from the Taskforce on Pension Scheme Voting Implementation highlighted this need.

The information they provide about the characteristics of their funds, their stewardship approach and how they contribute to sustainable value creation is critical to enable asset owners to make well informed decisions both at the outset of the relationship and on an ongoing basis. We are seeking for the industry to take forward this approach in the implementation and ongoing management of their relationships. The IA has committed to work with its members, asset owners, Government and Regulators to help establish a mechanism to improve client voice in the relationship including realising the concept of expression of wish, amongst others, in a way that makes sense for asset owners and their investment managers.

Implementation Review

The Steering Group call on the IA and PLSA to monitor the ongoing development and implementation of their recommendations and to work with their members to ensure that these recommendations are implemented and as a result a significant change in market dynamics is achieved. The IA and PLSA should conduct a formal review of developments after 18 months and report publicly on their implementation progress.

1. BACKGROUND AND INTRODUCTION

BACKGROUND TO THIS REPORT

The Asset Management Taskforce Report, *'Investing with Purpose: Placing Stewardship at the Heart of Sustainable Growth'*, challenged the investment industry to put the interests of clients and savers at the heart of stewardship; supporting them to have a tangible sense of ownership and engagement with their investments.

The relationship between asset owners and investment managers sets the tone for sustainable value creation right across the investment chain. However, several stakeholders have expressed concerns that these relationships are not working as effectively as they could, to promote and incentivise the alignment of stewardship and long-term, sustainable investment behaviours. These challenges have been identified as being particularly acute in the case of the relationship between pension funds and their investment managers. The FCA set out these issues as part of their Feedback Statement on their Discussion Paper for Building a Regulatory Framework for Effective Stewardship. An industry workshop hosted by the FCA, FRC, TPR and DWP (the joint-regulator workshop) followed. Participants identified the importance of addressing the focus on stewardship in the relationship between asset owners and managers.

In response to these concerns, the Investment Association (IA) and Pensions and Lifetime Savings Association (PLSA) were tasked by the Asset Management Taskforce to bring together the pensions

and investments industries towards a common goal – to put stewardship at the heart of the relationship between asset owners and investment managers. They committed to finding solutions for how the relationship between asset owners and investment managers can be governed in a way that promotes a long-term focus and aligns stewardship expectations; including the behaviours and actions that both asset owners and investment managers should undertake, with collective responsibility, to improve this alignment in their relationships.

The IA and PLSA set up a joint steering group in 2021, consisting of a representation of asset owners and investment managers with experience across investment, stewardship, and product as well as representatives from the investment and legal consultant communities. Whilst there are pockets of good practice, there is no silver bullet solution to strengthening the relationship between asset owners and investment managers, to be more focused on sustainable value. A consistent effort is needed by both parties, at each stage of the relationship, underpinned by effective governance and documentation. This report sets out key considerations to support this focus at each stage of the relationship. These recommendations are, for the most part, asset-class agnostic and should be considered in the context of different asset classes and investment strategies. Recognising the diversity of asset owners and investment managers operating in the UK market with differing investment objectives,

This report focuses foremost on the relationship between pension fund clients and their managers. This client group has strategic importance to the UK market, representing **55% of total institutional assets (£4 trillion)** and providing an income in retirement to millions of people in the UK.



business models, and governance approaches, it is clear there is no one size fits all solution. The recommendations can be adopted and adapted to suit varying needs in different investment relationships and shouldn't be seen as prescriptive guidance. Nevertheless, there is a clear underlying message that all parties do need to step up to a minimum standard to support more sustainable investment relationships, and we have provided specific recommendations for asset owners, investment managers, investment consultants and other service providers.

This report focuses foremost on the relationship between pension fund clients and their managers. This client group has strategic importance to the UK market, representing a significant proportion (55% of total institutional assets (£4 trillion)) and providing an income in retirement to millions of people in the UK. There are important challenges to address within this group to facilitate a relationship which focusses on long-term, sustainable value. We anticipate that the learnings from this report will be broadly applicable to the broader institutional investment community, including for insurers, charities, and sovereigns.

THE IMPORTANCE OF STEWARDSHIP TO DELIVERING LONG-TERM VALUE TO SAVERS AND PENSION SCHEME BENEFICIARIES.

In 2020, institutional clients accounted for the majority of investment management industry clients, responsible for 79% of assets (£7.4 trillion) under management in the UK. As the providers of capital, asset owners have a significant opportunity, and responsibility, to allocate and manage this capital responsibly, to deliver long-term, sustainable value on behalf of savers and beneficiaries. The FRC define this as Stewardship:

“Stewardship is 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”¹

The mandate asset owners give to investment managers to invest on their behalf should be governed by a mutual commitment to effective stewardship, so that in turn, investment managers are obliged to allocate capital and oversee their investments in companies and other assets in a manner which is consistent with the time horizon and investment objectives of the end beneficiaries.

All actors along the investment chain are facing an unprecedented challenge to support the economy to transition to net zero carbon emissions. These challenges pose a significant threat to the long-term value of pension scheme investments. Significant effort is therefore needed to support investee companies and other assets to transform their business to meet this expectation. Collaboration between asset owners and investment managers, with a clear focus on sustainable value, is essential to navigate these challenges.

STEWARDSHIP BY ASSET OWNERS

Savers and institutions have different investment goals and time horizons – they may be investing for growth or for income, have different risk appetites and may also have preferences to achieve positive environmental or social impacts. Investment objectives are designed to meet these goals over the relevant time horizon and asset owners will articulate how they expect these to be achieved through specific investment and stewardship policies.

Responsible capital allocation is a core component of effective stewardship. Stewardship starts with asset owners choosing investment strategies that will meet their investment objectives and then choosing an investment manager to invest on their behalf through mandates or the selection of funds consistent with these objectives. The majority of UK based pension schemes delegate investment activity in this way, with some notable exceptions, particularly larger asset owners who have their own in-house investment management teams. These asset owners may also conduct their own company engagements and set their own voting policies.

¹ FRC, UK Stewardship Code

After delegation, a key stewardship role for asset owners is the oversight of the investment and stewardship responsibilities they have delegated to their investment managers. The contractual relationship is an important way to ensure the obligations on their manager reflects their investment and stewardship objectives and to ensure there is the opportunity for effective oversight.

Asset owners' stewardship role can therefore be exercised through:

- The development of investment and stewardship policies to meet their investment objectives.
- The appointment of investment managers consistent, or as near as possible, with these policies.
- Setting expectations for their investment managers or other service providers on stewardship and collaborating with other asset owners to reinforce these expectations
- Setting up the investment relationship to have appropriate governance and incentives to focus on sustainable value creation consistent with the investment time horizon of the beneficiaries.
- Ongoing oversight of the mandate against their objectives, including through dialogue and performance assessment.
- Reviewing the outcomes and effectiveness of stewardship undertaken on their behalf
- Conducting advocacy work with regulators, governments, and standard setters on systemic issues
- Participating in joint initiatives with other asset owners, managers, and stakeholder groups.

For some asset owners, this may also involve collaborative and direct engagement with companies and exercising rights and responsibilities.

STEWARDSHIP BY ASSET MANAGERS

When people think of stewardship, they often think of shareholders exercising their voting rights in listed equity. However, stewardship activities involve every part of the investment process from research and monitoring to engagement with company management, exercising rights and responsibilities, to making investment decisions (including whether or not to invest in, reduce, exit or threaten to reduce or exit, an asset). Effective Stewardship should also cover different asset classes and geographies. Investment managers pursuing an active strategy can reflect their stewardship priorities and those of their clients in the selection and retention of investments.

Stewardship includes actions to engage with and hold to account investee companies to align incentives between investors and company management and encourage behaviours that promote long-term sustainable value. It also involves identifying and managing both financial and strategic risks to the long-term value of investments. An important way that investment managers manage these risks is to incorporate the wider set of financial and material Environmental, Social and Governance (ESG) risks and opportunities into the investment process. We set out below some of the stewardship activities that managers may undertake on behalf of their clients:

Investment choices:

- **Research** – investment managers research and assess which companies and assets will help meet clients' investment objectives. They conduct this research in due diligence exercises prior to investment and on an ongoing basis to inform their investment and engagement approach.
- **Investment choices** – Active managers will buy and hold companies and assets that help them to achieve their client's investment goals and sell those that won't. Exiting (or threatening to exit) an investment due to stewardship concerns can be seen as the last resort when all other approaches and engagement has resulted in no change. However, it can also be used as a first port of call, refusing to invest in companies where there are concerns about ESG criteria.
- **Monitoring** – Ongoing monitoring of investee companies and assets to assess the risks and opportunities to long-term value. This includes monitoring of third-party managers in fund of fund arrangements.

Engagement:

- **Setting expectations** – investment managers set out their expectations of companies and communicate these expectations regularly in direct engagement with management and board members.
- **Engage** – investment managers engage with the companies they invest in year-round to ensure that their expectations are being met. In dialogue with company management and board members, investment managers raise issues which they think pose a material risk to the company and want to understand how companies are managing those risks and responding to their concerns or views.
- **Collaboration and escalation** – If investment managers don't think that companies or the managers of assets are responding to their views, they may escalate their engagement or voting approach. This may be by tabling resolutions at an AGM or GM, or by making public statements or voting against the re-election of individual directors. Other mechanisms include formally writing to the whole board where they have serious and unresolved concerns which have not been addressed by the CEO or Chair. Escalation may also involve working with other investors either formally (through organisations such as the Investor Forum) or informally, on specific shared concerns.

Exercising rights and responsibilities:

- **Exercising rights and responsibilities** – investment managers make use of voting and other rights to influence company and asset behaviour. These rights will vary dependent on the type of security.

There are currently **199 signatories** to the Stewardship Code, 38 asset owners, and 141 investment managers with a combined £33tn Assets Under Management

CURRENT STATE OF THE RELATIONSHIP BETWEEN ASSET OWNERS AND INVESTMENT MANAGERS

The UK has a long history of investor stewardship. This has been driven by an engaged institutional client base with long-term investment time horizons and a view that effective stewardship will lead to sustainable value for savers and beneficiaries. The UK's Stewardship Code was the first in the world and the principles behind it were originally developed by a representative group of asset owners and investment managers through the Institutional Shareholders Committee. The revised UK Stewardship Code 2020 (the Code) sets a world-leading and ambitious standard for stewardship, through Principles and reporting expectations that set out the key behaviours of an effective steward for both asset owners and investment managers (and service providers). There are currently 199 signatories to the Stewardship Code, 38 asset owners, and 141 investment managers with a combined £33tn Assets Under Management².



² [https://www.frc.org.uk/news/march-2022-\(1\)/frc-encouraged-by-investors-embracing-the-spirit-o](https://www.frc.org.uk/news/march-2022-(1)/frc-encouraged-by-investors-embracing-the-spirit-o)

Reflective of the maturity of the UK market on stewardship and sustainable finance, many UK asset owners and investment managers are demonstrating leadership in aligning stewardship expectations and a focus on sustainable value in their investment relationships.

Increasing focus on stewardship and ESG integration has been driven in part by regulatory changes for pension funds, formally requiring them to set out their approach to stewardship as part of their Statement of Investment Principles (SIP), and how they have met these Principles in annual Implementation Statements (IS). This has resulted in increased scrutiny of investment manager's approach to stewardship and ESG integration. The introduction of TCFD reporting for pension funds is increasing this scrutiny even further.

There are variations in stewardship practices amongst different asset owners. While this can be driven by size, with larger actors often dedicating more resource to stewardship, this is by no means the only factor with a number of small to medium sized asset owners also paying significant attention to stewardship and innovating to drive forward market best practice. The UK pension fund market has been characterised by a significant long tail of smaller pension funds, albeit DWP policy is encouraging a shift towards consolidation and a smaller number of schemes with larger asset pools. The size of the fund has important implications for how much resource smaller funds can place into shaping and monitoring fully fledged stewardship strategies and ensuring their relationship with their managers is governed by these.

With the establishment of master trusts and government intervention to encourage consolidation, the number of DC schemes is falling every year, whilst Government and Regulators have committed to the creation of a regime for the establishment of superfunds to encourage consolidation and both superfunds and DB master trusts are already being established with oversight by TPR. This will naturally have implications for the relationship with asset

owners and investment managers and the resources available at pension funds to provide oversight of the relationship with their investment manager and implementation of stewardship activity.

The UK Government and financial regulators are clear on their expectations to encourage more signatories to the Stewardship Code³ and the IA and PLSA are committed to support their members to become signatories. A welcome recent initiative to support a wider range of pension schemes to embrace their stewardship responsibilities is the Occupational Pension Stewardship Council which was established in July 2021, with members from a variety of sized schemes in response to a recommendation of the Asset Management Taskforce Stewardship Working Group.

Several stakeholders have however expressed concerns that the relationship between asset owners and investment managers is not working as effectively as it could, to effectively promote and incentivise alignment of stewardship and long-term investment behaviours. In a joint discussion paper in 2019, the FRC and FCA identified several remaining barriers to effective stewardship including that "investment mandates, voting guidelines and other arrangements between asset owners and asset managers may not be fully aligned with asset owners' and beneficiaries investment and stewardship objectives." The FCA encouraged the investment industry to accelerate market led initiatives to overcome these barriers.

Below, we provide an overview of these concerns articulated by different stakeholders, identifying areas for improvement for both asset owners and investment managers.

³ TPR & Green Finance Roadmap

ISSUES THAT NEED TO BE ADDRESSED BY ASSET OWNERS⁴

- Underdeveloped stewardship policies result in a lack of clarity on stewardship expectations when appointing an investment manager.
- Stewardship is not a core feature of selection decisions and oversight and performance assessment, instead it is often treated as a hygiene factor, with other considerations such as cost and recent performance driving selection decisions.
- Incentives and resources put in place to govern the relationship, such as the contractual terms and expected reporting items can incentivise a focus on short-term performance.
- Market pressure to focus on and measure 'activities' instead of stewardship outcomes for long-term value.

ISSUES THAT NEED TO BE ADDRESSED BY INVESTMENT MANAGERS

- Low levels of consultation and engagement with clients on their stewardship policies and priorities.
- Lack of innovation in product development to meet client's stewardship expectations, with some clients expressing frustration at the inability to influence their managers' stewardship and voting approaches in pooled fund arrangements⁵.
- Disconnect between firm level stewardship policies and the investment objectives of the fund or product.
- Lack of detail and disclosure on voting policies
- Conflict between short-term performance and long-term stewardship objectives.
- Inconsistent approaches to stewardship and vote reporting and lack of fund level disclosures makes it challenging for clients to compare approaches across managers and mandates and meet their own regulatory obligations.

MARKET WIDE CHALLENGES

These challenges are set against other market wide issues, such as a narrow focus on the role of voting in listed equities, insufficient attention paid to the role of stewardship in fixed income and other asset classes and a heavily intermediated investment chain. The relationship between asset owners and investment managers is also often significantly influenced and supported by other key stakeholders and especially investment consultants and legal advisers. These actors can play a significant role in supporting investment relationships which are focused on long-term, sustainable value and support stewardship alignment.



⁴ DWP's latest consultation on Climate and investment reporting echoes some of these concerns noting 'many SIPs make only high-level statements about delegating engagement and voting to asset managers'. TPR's latest climate adaptation report, notes that research of DB schemes approach to managing climate risk found that "There is limited ownership of stewardship policies, even though active stewardship can help trustees manage climate-related risks and deliver climate-related objectives."

⁵ The Taskforce for Pension Scheme Voting Implementation has highlighted several concerns regarding the relationship between investment managers and their clients on voting matters; noting several concerns with the voting infrastructure in the UK market which further exacerbate this issue.

2. PRE-APPOINTMENT – CLARIFYING AND COMMUNICATING STEWARDSHIP OBJECTIVES

Recommendation on pre-appointment

Asset owners should clarify and clearly articulate stewardship policies which cover the whole investment process, including the different asset classes in which they invest; consistent with their investment strategy and investment delegation approach. When choosing their investment delegation approach, asset owners should assess the resources, expertise and governance capacity to make effective decisions on investment and stewardship activities to promote long-term sustainable value and meet beneficiaries' investment objectives. There should be clear governance and resources in place to support these policies and ensure they evolve these policies over time, to remain focused on sustainable value. This will enable asset owners to enter a manager appointment process with clear expectations on the approach to stewardship and assess which investment managers, products or mandates will meet these expectations.

This is not new guidance and reinforces key expectations in the UK Stewardship Code, however we have addressed this, as it sets the foundation for the whole investment relationship. Historically, there has been a limited focus on stewardship policies by many parts of the investment chain. There has been a significant shift in asset owners' asset allocation from equities to fixed income, private markets, real estate, and infrastructure over the last two decades. DB pension funds' allocation to equity asset classes fell to only 20% in 2020. While we note that DC pension schemes continue to have significant equity exposure, reflective of their less mature memberships, we do expect this to change over time in line with shifting member demographics, resulting in more diversified portfolios. Policies that focus almost solely on voting and engagement in listed equities risk becoming unrepresentative of the stewardship conducted on behalf of scheme members.

Directing asset manager voting decisions, can separate a key stewardship activity from the investment process. By contrast, in order to promote long-term, sustainable value, stewardship must be integral to the investment strategy.

ASSET OWNERS SHOULD CLARIFY AND COMMUNICATE THEIR STEWARDSHIP POLICIES

To embed stewardship into the appointment process, asset owners must first clarify and communicate their stewardship expectations and policies. This will help to identify prospective managers and assess them against their ability to align with these policies.

Pension fund trustees should have already done work to identify their stewardship policies as set out in their Statement of Investment Principles. It is important to note that DWP's latest consultation on 'Climate and Investment Reporting' notes concerns that "many SIPs make only high-level statements about delegating engagement and voting to asset managers... Trustees are encouraged to take ownership of the scheme's stewardship policies. This means it is not enough for trustees to simply report that they have delegated stewardship to their asset managers." This implies a clear regulatory expectation that pension funds should go into greater detail about their stewardship priorities and what their stewardship policies entail. This level of detail will help them to align their policies when looking to appoint a new manager.

Specific stewardship policies and priorities could be driven by a range of factors including:

- investment beliefs and objectives
- assessment of risk exposure, including based on ESG-related risks and opportunities
- asset allocation across sector, geography and asset classes

Policies may be high level and principles based (e.g. thematic engagement with global standards such as the UN Global Compact) or more granular and specific (e.g. specifying the balance of engagement versus divestment expected on carbon intensive assets, or further detail on thematic priorities such as workforce engagement).

The 12 principles of the UK Stewardship Code, falling under the areas of Purpose and Governance; Investment approach; Engagement and exercising rights and responsibilities, may be a helpful starting resource for the development of these policies, but asset owners will have to consider the specific issues or themes which are important to the asset owner and its beneficiaries:

- **Purpose and Governance:** expectations on the purpose, values and investment beliefs, and how fund management teams are incentivised to undertake stewardship through governance, training and remuneration.
- **Investment Approach:** Expectations on how stewardship considerations feature in the investment decision – e.g. decisions to divest/invest or engage; or thematic priorities on strategic and material ESG issues
- **Engagement:** Expectations around escalation of engagements and participation in collaborative fora. Such as the kinds of issues you would like to see managers engage on collaboratively.
- **Exercising rights and responsibilities:** Expectations on use of rights to influence issuer behaviour.

ASSET OWNERS SHOULD DECIDE THE LEVEL OF DELEGATION OF INVESTMENT AND STEWARDSHIP ACTIVITIES

Most asset owners choose to delegate investment responsibility to an investment manager through a segregated mandate, or by investing in a pooled fund product. Many asset owners also invest with a fiduciary manager. In a segregated mandate, as the investments are being run solely for the individual client, there is more opportunity to influence the ongoing management of the portfolio. In a pooled fund investment, the asset owner is selecting a fund which best meets their investment objectives.

Asset owners should consider how their approach to delegating investment and stewardship activities is consistent with the objective to promote sustainable value. Effective stewardship is part of and reinforces the investment strategy. Asset owners should oversee any stewardship activities carried out by third parties on the scheme's behalf, as far as that is practical. Where trustees are looking to have more influence on the investment and stewardship activities of their selected provider, they will need to have the resource, expertise and governance capacity to make effective recommendations and decisions consistent with their investment objectives. They will need to seek legal advice where this influence amounts to 'direction' as this would involve taking on legal responsibility for day-to-day investment decisions.

This decision will inform the approach to mandate and product selection – are they looking for products which align with their stewardship policies, and where implementation is fully delegated to the manager, or are they looking to influence or even direct the stewardship activities the manager undertakes on their behalf? More bespoke options are available within segregated mandates. Such as options to direct voting decisions for individual securities will typically be available within a segregated mandate. There are some products available which enable clients to adopt their own voting policy – within a pooled fund structure where their proportion of the pooled fund is separated out to allow votes to be cast in accordance with a specific voting policy. Where the voting policy deviates from the house approach, this may not align with the managers' engagement approach with the company.

Asset owners with more significant in-house stewardship and investment resource are more likely to take a more directive approach. Common reasons for this are:

- having significant in-house resource to dedicate to stewardship and wishes to develop a bespoke approach.
- having common securities holdings across multiple mandates and wishes to ensure consistency in the stewardship approach across these mandates.
- wanting to ensure their stewardship approach reflects the views of their beneficiaries.

It is important to identify how the delegation approach supports a focus on long-term, sustainable value. Asset owners should consider:

- the impact and influence the manager will have on company behaviour through leveraging their securities through direct or pooled holdings.
- the availability of in house-expertise and resource to conduct engagements or make decisions about how to exercise rights and responsibilities to promote long-term value for beneficiaries.
- the availability of governance resource to evolve their stewardship policies in response to changing best practice.
- compliance and reporting requirements associated with holding securities and exercising rights associated with them.

Asset owners can still engage with and influence the stewardship approach of their manager where they choose to delegate their investments and stewardship activities, and this should be considered part of their stewardship responsibility to oversee capital invested on their behalf.

Where smaller asset owners have decided to delegate their investment and stewardship responsibilities to a manager, it will be important to work their consultants to consider a proportionate approach to ongoing engagement with their managers, based on the resource and expertise available to them.

In chapter 6, we make specific recommendations for the actions that investment managers can be taking to consult their clients on their stewardship expectations and facilitate client voice.

GOVERNANCE AND RESOURCES OF ASSET OWNERS TO IMPLEMENT STEWARDSHIP GOVERNANCE

When developing specific stewardship policies and priorities, asset owners need to consider the resource and capabilities they have available to dedicate to the governance and ongoing development and execution of these policies. The ongoing development of these policies is essential to ensure they are evolving with best practice and continue to be aligned with enhancing long-term sustainable value.

Stewardship Code – Principle 5

Signatories review their policies, assure their processes, and assess the effectiveness of their activities.

This is an even more important considering the fast-moving nature of best practice in Stewardship and ESG.



3. PRINCIPLES FOR EMBEDDING STEWARDSHIP IN THE MANAGER APPOINTMENT PROCESS

Recommendation on the Manager appointment process

Investment Managers – Investment managers should share fund or mandate level information about their stewardship approach and how it supports their investment strategy. This should include the Stewardship policies and approaches for the firm and the specific fund, so that asset owners can fully understand the manager's stewardship approach. This will support prospective clients to make an informed decision on whether the fund meets their needs and beneficiaries' priorities. They should also share clear information about how they will facilitate client voice on stewardship matters and how they will facilitate a collaborative relationship with clients focused on sustainable value.

Asset owners – Asset owners should embed a focus on sustainable value in the manager appointment process by:

- Assessing and monitoring culture and values alignment of the two firms and how this will support a focus on sustainable value
- Placing greater value on stewardship alignment in the selection criteria and ultimate decision
- Assessing the incorporation of stewardship in the whole investment process across different asset classes and strategies
- Assessing managers capacity to meet evolving expectations and best practice as part of a commitment to a long-term relationship.

Investment consultants – Investment consultants should support this process by committing to scrutinise the stewardship capabilities of investment managers when supporting asset owners with their selection process and filtering prospective product choices. This should include an assessment of the integration of stewardship into the investment process and across different asset classes and strategies. They should also work closely with asset owners to identify the culture and values that will enable them to work with their managers as part of a commitment to a long-term relationship. Investment consultants should also demonstrate their commitment to incorporate stewardship and long-term investment into the relationships of their clients and investment managers by demonstrating their commitment to the Stewardship Code by becoming signatories.

Embedding stewardship into the manager appointment process should set the foundation for a relationship which has clarity over mutual expectations on stewardship, and which prioritises sustainable value creation.

Asset owners make manager selection decisions after considering a range of factors, including cost and investment capabilities – ultimately what is driving this decision is whether the product or mandate will contribute to the fulfilment of their investment objectives on behalf of their beneficiaries. Stewardship should form a key component of this decision and should not be treated only as a hygiene factor. This should be supported by a focus on alignment of culture and values to support a commitment to a long-term relationship. To inform the appointment decision, investment managers should clearly articulate their stewardship offering and clients should clearly communicate their stewardship expectations. This information exchange will enable prospective clients (and their advisors) to assess whether the managers' approach aligns with their own stewardship policies and expectations. It is also an opportunity for managers to understand the clients' priorities and ensure that their product offering is suitable to their needs.

This chapter sets out some key principles to support clients integrating stewardship into the Request for Proposal (RfP) and selection process, building on the Principles of the UK Stewardship Code. As a clear marker of best-in-class stewardship the aim is to complement the Principles of the Code and offer an interpretation of how they can be reflected in the RfP and selection process.

Many asset owners will be supported by advisers in the development of stewardship policies and in the manager appointment process. Investment consultants should have a clear understanding of their client's stewardship policies (see previous chapter) to inform the search and decision-making process. In many cases, asset owners will be re-tendering for existing mandates. We hope these principles can also be used for asset owners who are going through a review process with their existing managers as well as those seeking new mandates.

1. EXPLORE THE ALIGNMENT OF CULTURE AND VALUES AND HOW THIS WILL SUPPORT A FOCUS ON SUSTAINABLE VALUE.

A long-term relationship focused on sustainable value creation will be underpinned by an effective ongoing dialogue between the two partners collaborating towards shared objectives.

Stewardship Code – Principle 1

Signatories' purpose, strategy and culture enable them to promote effective stewardship.

Stewardship Code – Principle 2

Signatories' governance, resources and incentives support stewardship.

As part of the RfP and selection process, a focus on the culture and values of the two organisations will establish whether there is the potential for a successful long-term relationship. It will be helpful to understand the culture and values of the firm but also the specific fund management and client relations teams that you would have day to day contact with.

Areas to explore include:

- The **values** of the investment management firm and fund management team and how they align with the asset owners.
- How the **culture and purpose** of the organisation is monitored and reinforced – culture can evolve over time in response to personnel changes, external events and business transformation. It is helpful to understand how the manager monitors and reinforces its culture to have confidence that a positive culture focused on long-term value will persist over the time frame of the mandate. The IA's culture framework provides further information on the issues to be addressed.

- The **coherence** between the expectations that the firm sets of investee companies, and the approach that the firm takes to its own business. For example, what is the firm's approach to monitoring the environment, pay or diversity in its own organisation? The Asset Owner Diversity Charter provides a tools on improving diversity.
- **The focus on sustainability** – many asset owners are looking to work with managers who are focused on their wider impact as investors and contribution to a sustainable environment, society and economy.
- The approach to **diversity and inclusion** – Inclusive businesses with strong diversity of thought have typically delivered better business decisions and support a better focus on long-term value. How is the manager evidencing their commitments in this area?
- How the **governance of stewardship** within the firm is supporting evolving best practice – governance (and particularly board or executive level oversight) is a key tool to ensure the systematic integration of stewardship into the investment process and will be reinforced by a culture focused on sustainable value. Such as how stewardship and ESG integration is incentivised through remuneration structures and other governance practices, including training provision.

2. PLACING GREATER VALUE ON STEWARDSHIP IN SELECTION CRITERIA.

Through placing a high value on the firms' stewardship approach in selection criteria, and being transparent about this value, the asset owner can set the tone for a relationship which is focused on stewardship and incentivises sustainable value creation. Conversely, an approach which treats stewardship as only a 'hygiene' factor may discourage a long-term investment approach.

Asset owners should identify how important stewardship is to their selection decision (what weight it will be given in the final decisions) and ensure this is reflected in the approach they take to inviting managers to tender; scoring RfPs; progressing managers to the final stage and making the appointment decision.

Being clear about these expectations and the weight that stewardship and ESG integration will play in advance of inviting managers to tender gives a clear indication of expectations. Asset owners may wish to tell prospective managers in advance about the approach that they will take to assessing stewardship and ESG capabilities. This transparency helps send a clear signal about the prioritisation of sustainable value in the investment relationship.

Stewardship Code – Principle 7

Signatories systematically integrate stewardship and investment including material environmental, social and governance issues and climate change, to fulfil their responsibilities. Reporting expectations include that signatories should explain 'how they have ensured tenders have included a requirement to integrate stewardship and investment including material ESG issues'.

To promote the importance of stewardship in this process, asset owners should consider:

- Requiring managers to meet minimum criteria on stewardship and ESG in order to be invited to tender. Such as they are signatories to the:
 - UK Stewardship Code or international equivalents.
 - The net zero asset manager's alliance
- Requiring managers to achieve a minimum scoring on stewardship and ESG integration in their RfPs to be considered for appointment.
- Placing a high value on RfP responses which demonstrate the integration of stewardship into every aspect of the investment process, rather than treating stewardship or responsible investment as a standalone item.



Through placing a high value on the firms' stewardship approach in selection criteria, and being transparent about this value, the asset owner can set the tone for a relationship which is focused on stewardship and incentivises sustainable value creation

3. FOCUS ON STEWARDSHIP ACROSS THE INVESTMENT PROCESS, ACROSS AND WITHIN DIFFERENT ASSET CLASSES AND STRATEGIES.

a. Stewardship across different asset classes

Many investment managers will be on a journey towards the full and systematic integration of stewardship and ESG into the investment process, across and within different products and asset classes. The systematic integration of stewardship involves the consideration of stewardship issues and ESG factors at every stage of the investment process and across different asset classes, investment strategies and geographies.

Effective Stewardship can enhance and protect long-term value in a wide range of asset classes and investment strategies. How stewardship is applied in different asset classes will be driven by the rights and responsibilities associated with investing in them, as well their investment characteristics and time horizons. Different securities have different levers to pull to influence the behaviour of investee companies. RfPs should seek to understand the managers' approach to stewardship in the asset class and investment strategy under consideration.

Stewardship Code – Principle 12

Signatories actively exercise their rights and responsibilities.

For multi-asset funds the asset owner should seek a balanced understanding of how stewardship is implemented across the investment portfolio. An imbalance of questions on stewardship solely focused on listed equities, may not uncover a full understanding of how the managers approach to stewardship can support sustainable value.

Principles 9-12 of the Stewardship Code, focused on engagement are relevant across all asset classes.

b. Stewardship across the investment process

Voting is just one component of the stewardship process. For listed equities it is essential to understand how voting forms part of the wider stewardship and engagement strategy. Such as how voting forms a part of an escalation engagement strategy if shareholders are not receiving an appropriate response from companies through engagement.

Asset owners should seek to uncover the extent to which stewardship and ESG is integrated into every part of the investment process – across:

- Investment choices (research, monitoring, selection/ de-selection)
- Engagement (setting expectations, engagement, escalation)
- Exercising rights and responsibilities (e.g. exercising voting rights)

A key part of understanding how well embedded stewardship is into the investment process is to understand how the ESG or stewardship team works with the investment team. Seeking to understand the manager's approach to resourcing and incentivising stewardship is helpful to uncover this approach.

It is also important to understand how the stewardship approach of the firm supports or contributes to the investment approach of the fund or mandate under consideration.

4. ASSESS CAPACITY FOR EVOLVING BEST PRACTICE AND COMMITMENT TO A LONG-TERM PARTNERSHIP

We proposed at the beginning of this report that asset owners and investment managers should aim to build collaborative long-term relationships that can evolve in response to a changing external environment and emerging best practice. This collaborative approach is key to addressing market wide and systemic risks including sustainability challenges.

Both party's approach to stewardship will naturally evolve over time in response to changing best practice. To maintain a focus on long-term sustainable value, it is essential for both parties to have a framework for dynamic and transparent dialogue and communication of expectations.

The RfP process is a key opportunity to assess the potential for a long-term relationship, and how the manager is committed to working with their client to evolve their stewardship approach over time.

Stewardship Code – Principle 5

Signatories review their policies, assure their processes and assess the effectiveness of their activities.

Stewardship Code – Principle 8

Signatories monitor and hold to account managers and/or service providers.

To assess the potential for a long-term relationship, it is helpful to understand:

- Where the manager is on a journey to integrating stewardship and ESG systematically into the investment process. This could include consideration of what resources are being deployed to improve stewardship practices and how this translates into the particular product or strategy. The manager may be dedicating increasing resource to stewardship and ESG through dedicated personnel and technological solutions.

- The managers' approach to seeking and responding to feedback from clients and other stakeholders.
- The managers' approach to consulting and seeking client views in the ongoing development of their stewardship policies and practices– how does the manager facilitate client voice through formal and informal mechanisms?

Clients and their advisers may identify that there are some gaps in the delivery of their stewardship policies and objectives. In these cases it will be important for them to form a view on whether the product offering is still suitable and to come to an agreement with their manager about how they will address any gaps.

5. FOCUS ON EVIDENCING OUTCOMES

Effective stewardship should enhance sustainable value for clients and beneficiaries. An important focus of the UK Stewardship Code is on stewardship 'activities and outcomes' over and above 'policies and processes'.

It is important to focus on the manager's approach to achieving stewardship outcomes and how this has contributed to sustainable value. The asset owner can place an emphasis on this in the RfP and selection process by seeking to understand:

- How the manager defines 'stewardship outcomes' and how these are monitored and assessed.
- How the manager distinguishes between and prioritises different types of engagement activity (e.g. engagement for information, or engagement for influence).
- Evidence of recent examples of engagements which have resulted in better long-term value for their clients.

INFORMATION SHARED BY THE MANAGER TO SUPPORT THE SELECTION PROCESS

Investment Managers should share fund level information about how their stewardship approach supports the investment strategy to prospective clients to support them to make an informed investment decision. They should also share clear information about how they will facilitate client voice on stewardship matters.

The information investment managers provide about their stewardship approach and how this contributes to sustainable value creation is critical for asset owners to make well informed selection decisions. The manager should share a range of information to inform prospective clients on their approach to stewardship and importantly, what this means for the fund under consideration.

a. Firm level approach to stewardship

Significant information regarding the firm level approach to stewardship will often be found in the firm's annual Stewardship Report to meet the requirements of the UK Stewardship Code (where they are signatories). This will be an important starting point for a significant number of enquiries on the firm's approach to stewardship, covering both policies and processes, as well as activities and outcomes from the year of the report. Essential information will also be provided in the engagement policies produced under the FCA's transposition of SRD II. Or other firm level disclosures, such as their submissions to the PRI. Many investment managers will also provide firm level overviews of voting records on a public site.

Given the significant role that stewardship will play in achieving firms' net zero commitments, they should also provide their TCFD reports and articulate how these relates to investment stewardship.

To support a focus on values and culture, the firm may also wish to share other firm wide policies such as their gender pay gap reports.

b. Fund level approach to stewardship

In addition to setting out their firm level approach to stewardship it is helpful for managers to articulate how this translates to the fund under consideration. This will enable asset owners to assess alignment for

their portfolio. The FCA is evolving their expectations on fund level stewardship disclosures, as a part of their work on Sustainability Disclosure Requirements and fund labelling⁶. The manager could consider providing information for the prospective client on:

- How their stewardship approach supports the objectives of the fund.
- Evidence of how stewardship has impacted on outcomes for the investment strategy of the fund in recent years.
- How does the firm wide resource and capabilities in stewardship translate into the capabilities of the fund management team under consideration? E.g., who leads the engagement?
- How they are investing in resource and capabilities for the stewardship capabilities for the fund.
- How the fund identifies and tracks progress towards stewardship outcomes.
- Where the strategy has a particular sustainability goal, the manager should identify how stewardship supports that goal.
- Whether the fund has any thematic stewardship and engagement priorities.

c. Facilitating client voice

Managers should clearly articulate how they will consult with clients to inform the ongoing development of their stewardship policies.

They should also articulate whether the fund under consideration allows clients to direct or influence the stewardship approach of the fund and what services are available to engage clients on their voting policies. This will enable asset owners to make informed decisions about their product selection based on the stewardship delegation approach they wish to take.

Stewardship Code – Principle 6

Signatories take account of client and beneficiary needs and communicate the activities and outcomes of their stewardship and investment to them.

⁶ <https://www.fca.org.uk/publication/discussion/dp21-4.pdf>

4. EMBEDDING LONG-TERMISM IN THE CONTRACTUAL RELATIONSHIP BETWEEN ASSET OWNERS AND INVESTMENT MANAGERS

Recommendation on the Contractual Relationship

Asset owners and investment managers should establish a ‘governing charter’ which sets out mutual expectations for how their relationship will prioritise and incentivise a focus on long-term, sustainable value. Investment consultants should commit to supporting the intention of the charter. This charter would cover mutual expectations on how the following will be focused on long-term, sustainable value:

- The expected minimum duration of the relationship
- Performance reviews
- Ongoing dialogue, communication and disclosures, including how to facilitate client voice
- Responsibilities to the market and management of systemic risks
- Culture and Governance
- Ongoing alignment of stewardship policies

The documentation that governs the relationship between asset owners and investment managers should incentivise and hold both parties to account for focusing on sustainable value. These documents can also support a commitment by both parties to a long-term relationship and collaboration.

Stewardship Code – Principle 7

Signatories systematically integrate stewardship and investment, including material environmental, social and governance issues, and climate change, to fulfil their responsibilities.

Under the reporting expectations for this principles, signatories should explain “how they have ensured-tenders have included a requirement to integrate stewardship and investment, including material ESG issues; and the design and award of mandates include requirements to integrate stewardship and investment to align with the investment time horizons of clients and beneficiaries”

Many stakeholders have expressed concerns that contracts “do not explicitly set stewardship objectives ...and that some contracts also include terms that may be incompatible with a long-term investment strategy (e.g., quarterly performance evaluation). “[FCA joint regulatory workshop]

Further work is therefore needed to embed stewardship in the documents which govern the relationship between asset owners and investment managers and ensure that these documents are encouraging a focus on sustainable value.

Key documents

There are several documents which govern the relationship between asset owners and investment managers. These can be considered in terms of the formal and binding contractual terms of the relationship and additional side notes and commitments. These vary depending on the nature of the investment product.

- For segregated mandates this is commonly governed by an Investment Management Agreement (IMA), which sets out the terms and conditions on which the client is contracting the manager to invest their assets on their behalf. In segregated mandates, the client has significant opportunity to negotiate the IMA to meet their needs.
- For pooled fund structures, the contractual relationship will commonly be governed by the fund rules as set out in the instrument of incorporation and prospectus or offering document. In pooled fund structures, there will be more limited opportunity to amend the terms and conditions of the fund as these have been established to support the manager to manage the fund to the benefit of all unitholders and will reflect the fund prospectus. There may be some scope to identify additional reporting capabilities or expressions of wish by way of side note agreements.

In this chapter, we recommend that asset owners and investment managers explore options to establish a ‘governing charter’ which sets out mutual expectations for how their relationship will prioritise and incentivise a focus on sustainable value. The concept of a ‘governing charter’ has taken inspiration from ‘Brunel’s Asset Management Accord’⁷. The accord is not legally binding but outlines a set of principles and values that will define the relationship between owner and manager and engender long-termism, greater alignment of interests and increasing transparency and communication between the two parties. Building on this concept, we set out some key principles to support the development of the charter. To be effective these principles should be adapted to reflect the particular investment objectives and nature of the agreement between the asset owner and manager.

We have also made suggestions for improvements that need to be made to the formal contractual documents to embed a focus on stewardship. The IA’s legal committee have committed to explore how to update the IA’s model IMA to embed a focus on sustainability and stewardship as part of their 2022 refresh. This would reflect some of the most recent regulatory developments in stewardship and sustainability and also explore how to capture clients’ stewardship policies and expectations in the contractual relationship.

Some asset owners could consider embedding a broader range of sustainability objectives into their investment mandates using the ICGN’s model mandate initiative. The ICGN’s Model Mandate produced in collaboration with Global Investors for Sustainable Development Alliance sets out guidance on how asset owners can articulate their expectations on long-term investment approaches in their contractual relationship with managers. It has recently been updated⁸ to reflect evolving stewardship practices and to support alignment with the UN’s Sustainable Development Goals.

DEVELOPING A GOVERNING CHARTER

The development of a governing charter can help set the tone for a long-term relationship which not only sets expectations of the investment manager but also of the asset owner. The charter would build on the key principles, discussed in previous chapters for embedding stewardship in the selection process.

The development of such a governing charter would be most impactful for medium to large sized asset owners. Those who are in the process of committing more resource and governance to stewardship and are evolving their approach to best practice. The steering group believes that these asset owners would benefit from formalising a focus on sustainable value through their relationship with their managers. For smaller asset owners, with more limited resource, we recognise that the commitment to the ongoing obligations may be too burdensome, however we would recommend that smaller asset owners still consider if there are elements of the below that they could adopt.

The advisory community (in particular investment consultants) play a key role in facilitating a focus on long-term sustainable value for their pension funds clients. This role is only heightened for smaller asset owners who can be more reliant on the advice and analysis of their consultants, where they are unable to dedicate significant resource through their governance arrangements. We would like to see investment consultants commit to supporting the intention of the charter through the advice they produce for their clients.

Below, we set out a number of elements that asset owners and investment managers could consider incorporating into a governing charter. These are not intended to be prescriptive. To be effective these principles should be adapted to reflect the particular investment objectives, stewardship policies and nature of the agreement between the asset owner and manager.

Long term nature of the relationship – the charter could set out the expectation that the relationship is intended to be a long-term one to reflect the investment time horizon of the asset owners’ beneficiaries. This would allow both parties to work within an incentive framework that prioritises sustainable value.

⁷ <https://www.brunelpensionpartnership.org/wp-content/uploads/2018/11/Brunel-Asset-Management-Accord-2018.pdf>

⁸ <https://www.icgn.org/icgn-and-gisd-alliance-launch-newly-updated-model-mandate-guidance>

This could include expectations that the investment and stewardship objectives; performance cycle and KPIs should all be aligned. There would be a commitment on the part of the asset owner for this to be reflected in the timings and approach to performance assessment and reviews – since they are expecting the relationship to be focused on the achievement of long-term returns, short-term performance is of limited significance. This will be reflected also in the review cycle period and the support for both parties to address underperformance and develop their practices.

Performance review and assessment – This would be an opportunity to clarify the approach that the asset owner will take to review and assess performance and a commitment to how this will incentivise a focus on sustainable value. This should articulate the alignment of the investment and stewardship objectives, the performance review cycle and KPIs that are used to monitor performance. This may link to any framework the Asset Owner will have for how they will engage with any indicators of underperformance by the manager.

Ongoing engagement and communication – This is an opportunity to agree a framework for ongoing dialogue outside of formal performance assessments and how this will support a focus on sustainable value. This could include expectations on:

- how the client's views and feedback would be considered as part of the managers' ongoing approach to stewardship policy development.
- transparent and open dialogue about any areas of concern or underperformance. This could include how issues or concerns can be addressed by both parties and opportunities for the manager to address any pressure to prioritise short term over long-term value.
- while communications may be frequent as part of the ongoing monitoring and oversight, there would be a commitment that the nature of this communication shouldn't incentivise short-term performance pressures.

Responsibilities to the market and managing systemic risks including climate change – The charter could indicate any mutual responsibilities to contribute to sustainable financial markets and addressing systemic risks. This could identify how the manager and the owner will collaborate to address these risks.

Stewardship Code – Principle 4

Signatories identify and respond to market-wide and systemic risks to promote a well-functioning financial system.

Culture and governance – This would be an opportunity to formalise expectations discussed as part of the appointment process on culture and governance. This could for example set out expectations for the manager and owner to make improvements to team diversity over time.

Alignment with stewardship policies – The Charter could be used to articulate a mutual commitment to the ongoing alignment of stewardship policies and a framework for how these will remain aligned over time.

IA'S MODEL MANDATE

The Investment Association has developed a model IMA for discretionary management arrangements with professional clients, which can be adapted by the client and their managers to suit their circumstances. The IA's Legal Committee recently updated the model IMA⁹ to reflect recent regulatory developments. The model IMA contains clauses on voting authorities; and an optional placeholder schedule for sustainable finance disclosures relating to SFDR and TCFD at the discretion of the users.

The Committee plans to update the IMA further in 2022 to reflect the UK's latest developments in sustainability and stewardship including requirements on TCFD; the Sustainability Disclosures Requirements (SDR) and the Shareholder Rights Directive II (SRD II). We recommend that in addition to making updates to reflect regulatory developments in sustainability and stewardship, the Committee also explores options for updating the mandate to reflect best practice as per the UK Stewardship Code. Some of these items may not lend themselves to inclusion in the mandate itself but may be better suited to side notes which are more flexible to evolve over time in response to emerging best practice. It would also be helpful for the Legal Committee to explore which items might be best suited in the mandate itself or in relevant side notes.

Specifically, it would be useful for this work to consider:

- **Updates to the voting schedule:**

- Updates to reflect contractual obligations under the Shareholder Rights Directive II. This should consider how the mandate reflects disclosure obligations from the asset manager to pension scheme clients to support them to meet their own disclosure obligations under the DWP's transposition of SRD II and accompanying statutory guidance – e.g. including consideration of reporting on 'most significant votes'.
- Authorities for requisitioning resolutions – explore options for agreeing authorities to requisition resolutions. This could help to support a more efficient process for identifying underlying authorities to meet the relevant thresholds for requisitioning a resolution.

- **Stewardship in other asset classes:** How to set expectations regarding the manager's role in fulfilling their role as stewards in the full range of asset classes.
- Options to delegate authorities to conduct **company engagement** (e.g., where these have been separated within or from the investment manager through a dedicated stewardship service).
- Options to reflect agreements to implement the client's stewardship policies **or to align them with that of the chosen fund.**
- **Consider options for taking into account clients 'expression of wish' on voting.**
- **Reporting Responsibilities:** Explore how reporting responsibilities can be included in contractual arrangements.

⁹ Model IMA 2021.pdf (theia.org)

5. OVERSIGHT, ENGAGEMENT, AND COLLABORATION

Recommendation on Oversight, engagement and collaboration

Asset owners and investment managers should agree an oversight framework focused on long-term sustainable value, which aligns the performance review cycle, investment & stewardship objectives, and KPIs. This should include both quantitative and qualitative reporting items which enable a holistic view of the role of stewardship throughout the investment process and across different asset classes, and how stewardship activities have contributed to stewardship outcomes.

Ongoing dialogue should enable both parties to communicate evolving expectations on stewardship best practice, facilitate client voice and identify opportunities for collaboration.

Where managers carry out stewardship on clients' behalf, they should proactively consult their clients on their stewardship policies at on-boarding and on an ongoing basis. More frequent consultation with clients on their evolving preferences will help facilitate better alignment between clients and managers on their stewardship expectations and will support managers to respond to emerging expectations on best practice.

Where delegating investment responsibilities to an investment manager, results in asset owners' stewardship responsibility shifting to their oversight role, formal oversight of the managers' performance against the asset owner's stewardship and investment objectives is crucial to supporting a focus on sustainable value. It is important that the reporting KPIs promote a focus on sustainable value and avoid inadvertently creating incentives to prioritise short-term returns. Ongoing communication and dialogue outside of the formal performance review cycle will contribute to effective oversight.

These relationships will need to evolve over time in response to evolving best practice, a changing external and regulatory environment as well as changing culture and personnel. Having identified alignment at the outset of the relationship, a mechanism is needed to support ongoing alignment – constructive dialogue, consultation and engagement will support this ongoing alignment.

Done effectively, the reporting items, communication and governance that support this oversight will facilitate an investment relationship focused on sustainable value creation. Advisers such as investment consultants will play a key role in supporting the development of a robust oversight framework which is focused on sustainable value.

In this chapter we consider:

- the actions that asset owners and investment managers can take to agree an oversight framework focused on sustainable value
- the actions that asset owners can take to identify performance KPIs focused on sustainable value
- the actions that managers can take to facilitate client voice in their ongoing dialogue and engagement
- the actions advisers can take in supporting this process

SETTING UP AN OVERSIGHT FRAMEWORK FOCUSED ON SUSTAINABLE VALUE

Below we have set out some steps that asset owners and investment managers can take to agree an oversight framework that supports a focus on sustainable value. This is not intended to be a prescriptive list. Asset owners and their managers should consider a proportionate approach that will support them to assess and hold each other to account on achieving long-term, sustainable value.

The agreed approach should reflect the resource and capabilities the asset owner has to effectively scrutinise any reporting items, with support from their advisers where needed. The more detailed and frequent the reporting items, the more resource will need to be dedicated to producing and assessing them. It is important to therefore have clarity on how these reporting items will be used to support a focus on sustainable value. Managers will need to consider the costs of reporting as part of their product offering, especially where bespoke requirements are being set.

The principles discussed in chapter 3 for embedding a focus on stewardship into the RfP and selection process are just as relevant when developing an oversight framework. Effective oversight will consider not only the quantitative reporting items which

demonstrate performance but will also seek to assess the behaviours which are driving sustainable value.

As we have discussed throughout this report, effective stewardship is integrated into the whole investment process, and relevant across different asset classes and investment strategies. An effective oversight framework will give a holistic view of the stewardship approach for the investment mandate under consideration; giving a picture not just of one stewardship activity in isolation, but how this contributes to long-term value.

When setting up an oversight framework, both parties should agree:

- Alignment of the performance review cycle; investment & stewardship objectives; performance cycle; and KPIs – both parties should have confidence that this alignment is supporting a focus on sustainable value, in line with the investment time horizons of beneficiaries, over and above short-term returns. They should consider how the performance review cycle timeframe is aligned with a commitment to a long-term relationship.
- Frequency of reporting. It is important to have clarity over how the frequency of reporting is supporting a focus on sustainable value and which items will support meaningful scrutiny and oversight.
 - Which reporting items are needed more or less frequently (e.g., quarterly, yearly or as part of the performance review cycle).
 - Which items should be reported immediately outside of the performance review cycle (e.g. changes in management).
 - Discuss how to ensure that more frequent reporting items don't inadvertently incentivise a focus on short-term value.
- The role of advisers, third-party assurance and verification on reporting items.
- Qualitative and quantitative reporting items which demonstrates how different stewardship activities contribute to long-term value across the investment process and asset classes.
- A framework for assessing stewardship outcomes, aligned with the asset owners' stewardship policies.

IDENTIFYING KPIS THAT SUPPORT A FOCUS ON SUSTAINABLE VALUE

Effective oversight necessarily requires reporting of quantitative performance measures to assess whether the portfolio is on track to meet the investment objectives. This provides an essential accountability mechanism for asset owners to scrutinise the performance of their managers. However, a narrow focus on recent quarterly performance may undermine a focus on long-term sustainable value consistent with the investment time horizon of scheme beneficiaries and could inadvertently encourage short-term investment behaviours. It is essential that the time horizon of the investment and stewardship objectives; the reporting cycle and the specific KPIs that are identified to assess performance against these objectives are all aligned.

The asset owner and manager should agree reporting metrics and KPIs that will enable a focus on sustainable value. These should build on the reporting items necessary for the asset owner to meet their own reporting obligations to their own beneficiaries and wider stakeholders. For example, there are a number of existing reporting requirements under the regulatory framework e.g., under SRD II asset managers are required to “disclose to institutional investors the composition, turnover and turnover costs of their portfolio as well as their policy on securities lending.”

There will not be a one size fits all approach and asset owners should go through a process to identify which KPIs will support them to monitor progress towards sustainable value in line with their investment and stewardship objectives. For segregated mandates, these reporting items may be more bespoke. For pooled funds, there may already be particular KPIs associated with the relevant fund. It will be important to agree with the manager which additional reporting items may be necessary as part of the appointment process.

Areas to consider include:

- Identifying KPIs that support a focus on long-term performance e.g., Focusing Capital on the Long-term makes several suggestions for KPI's that better focus on long-term value.

- Identify metrics that support monitoring of the ongoing alignment of culture and values e.g. key personnel changes; remuneration incentives; progress against the gender pay gap.
- Identify metrics to assess effective stewardship including:
 - asset owners may wish to adopt the ICSWG's guidance for engagement reporting to support more consistent engagement metric disclosures between different managers and mandates.
 - Asset owners may wish to adopt the PLSA's vote reporting template to support more consistent vote disclosure metrics.
 - Identify ESG and sustainability metrics relevant to the investment and stewardship objectives¹⁰.
 - The IA commits to work with the FCA as it considers the need for stewardship KPIs as it implements SDR and fund labelling. The Group believe that in the first instance KPIs should be linked to the implementation of the fund strategy.

Investment consultants play a key role in supporting this process through:

- Supporting asset owners to identify the relevant performance metrics they wish to monitor and how to present these in a proportionate way to support effective scrutiny.
- Presentation of information that focuses attention on yearly and longer-term performance as opposed to on quarterly returns.
- Development and implementation of performance cycles aligned with investment objectives
- Being clear how they use any data from investment managers and how it will be presented to asset owners. Committing not to use it for general purposes to monitor or rank individual managers.

ASSESSING STEWARDSHIP OUTCOMES

It is important that stewardship oversight is focused on stewardship outcomes over and above stewardship activities. There is no easy way to measure and quantify how effective stewardship contributes to better investment outcomes. To date, stewardship reporting has been focused on firm level activities, and not necessarily on how stewardship has led to better investment outcomes in line with a particular investment strategy or fund. Quantitative approaches may lend themselves to focusing on the quantity of engagement activities (e.g. how many letters have been sent) over and above the impact that these activities have on long-term value. In future, it should also seek to not only focus on the positive outcomes of stewardship, but also where the stewardship outcomes have not been achieved and the way that the manager has learnt from these engagements and changed its approach as a result.

Asset owners could agree with their managers to dedicate more resource to monitoring certain securities (e.g., this could be based on risk profile; thematic engagement priorities; or size of holdings) in order to understand how over time, stewardship activities have led to better investment outcomes.

¹⁰ There is a quickly developing regulatory framework for sustainability reporting. In the UK, the Sustainability Disclosure Requirements and UK taxonomy will set new sustainability reporting requirements for companies, pension funds and investment managers.

IMPROVING ONGOING DIALOGUE AND COLLABORATION

Ongoing dialogue and engagement (outside of the formal performance cycle) can support effective oversight of the investment relationship. Asset owners and managers should agree a framework for this dialogue and refer to this in the governing charter.

This dialogue can take place in dedicated meetings, or through informal surveying and communications and should facilitate a shared understanding of expectations and support continued alignment of stewardship policies. Clients may wish to hear from dedicated stewardship teams, directly from fund managers or a combination.

More dynamic communication should:

- Allowing both parties to communicate evolving expectations on stewardship best practice.
- Support monitoring by the asset owner in line with their approach to assessing stewardship outcomes - an understanding of the stewardship activities that are taking place and the outcomes being targeted and achieved. This will provide the client with the opportunity to input their views into individual engagements.
- Identify opportunities for collaboration – e.g., participation in industry fora, collaborative engagements and engagement on market wide and systemic risks.
- Identify and manage any conflicts of interest as they arise.
- Provide a transparent dialogue about any underperformance against investment or stewardship objectives. The asset owner and manager should agree which areas should be brought to the immediate attention of the client outside of the performance review cycle.
- Provide updates on how the manager is evolving their approach to stewardship, growing their resource and capabilities, and developing their policies.

ACTIONS INVESTMENT MANAGERS CAN TAKE TO FACILITATE CLIENT VOICE

Stewardship Code – Principle 6

Signatories take account of client and beneficiary needs and communicate the activities and outcomes of their stewardship and investment to them.

To support more effective dialogue and engagement, there are some minimum steps that all asset managers can take to facilitate client voice in their stewardship activities. Managers should seek to understand their client's stewardship policies and expectations and how these may be evolving through regular consultation. This can be achieved through a combination of surveying, consultation, collective and 1-1 client meetings. Managers should consider how they use technological solutions to support them to achieve this.

Through this consultation activity, managers should seek to:

- Understand their client's stewardship policies and how these may be developing over time.
- Facilitate client input into manager policy development (yearly voting policies or identification of thematic engagement priorities) as they are developed and reviewed on a yearly basis. This is important to ensure client buy-in to emerging policies and supports the asset owners in identifying where their stewardship policies remain aligned with those of their managers.

Depending on the nature of the contractual relationship and investment product, asset owners and managers may agree to consult on more operational stewardship activities such as:

- decisions to escalate stewardship engagements (for instance to enter a collaborative engagement).
- stewardship decisions regarding any securities where they have identified an active monitoring requirement.
- specific engagement or voting activities– these might be where the activity is particularly contentious, high profile or forms a significant risk exposure for the client.

It is important to note that the ability of investment managers to take on board the specific recommendations of their clients when consulting on their stewardship preferences will be governed by the nature of their contractual relationship. In pooled fund structures, managers have a responsibility to make investment decisions in the interests of all unit-holders within the fund and it may not always be possible to align differing expectations from different clients. More bespoke arrangements may be more suited to segregated mandates.

Nonetheless, more frequent consultation with clients on their evolving preferences will help facilitate better alignment between clients and managers on their stewardship expectations and will support managers to respond to emerging expectations on best practice.

EXPRESSION OF WISH

In September 2021, the Taskforce for Pension Scheme Voting Implementation published 24 recommendations to government, regulators and industry on ***“how to facilitate more voting and better quality voting by occupational pension schemes by encouraging them to set voting policies and second, making recommendations that will support the changes in behaviours needed from service providers to meet this objective.”***

The report encourages Pension Scheme trustees to develop “expressions of wish” on their voting policies: “by setting the expression of wish the pension scheme indicates how they would like the shares to be voted...to represent a voting policy on any issue or group of issues.”

They define a ‘voting policy’ as “a set of guidelines or instructions issued by a pension scheme to an agent, to inform voting on their shares”.

The recently formulated concept of an “expression of wish” is an important development in enhancing client voice and could, if implemented effectively, provide additional insights on client’s stewardship priorities and how clients wish managers to exercise their voting rights at a strategic and policy-level. The formal concept of an ‘expression of wish’ in relation to voting is relatively new, and a progression from previous industry discussions around ‘directed voting in pooled funds’. The report notes there are legal issues with unit-holders directing their shares in pooled funds.

The FCA has since clarified that “that there is no regulatory barrier to pension scheme trustees’ issuing an ‘expression of wish’ to their asset managers regarding their voting preferences, and no breach of fund rules where a fund manager takes the expression of wish into account when voting.” DWP also supports this development “DWP sees no reason why trustees should not be able to set an expression of wish if trustees want to do so if it is aligned with their fiduciary duties.” In other words, the expression of wish cannot and will not override the fiduciary duty to act in accordance with the fund’s objectives.

Voting is an escalation tool that should form part of the overall stewardship process – reinforcing expectations of companies to promote long-term, sustainable value on behalf of savers and beneficiaries. At the same time, asset owners need to fully understand the extent to which it will be taken into account by the asset manager, who in turn should be clear and transparent about this in their marketing and other materials.

The 'expression of wish' concept could help asset owners to articulate to their managers their views on voting matters which they believe will enhance long-term value. An 'expression of wish' could take on different forms e.g.:

- A general statement about the importance of certain voting matters aligned with thematic stewardship priorities – e.g., the treatment of pre-emption rights, requisitioned resolutions on climate change.
- A specific voting policy, which details how to vote in certain scenarios (potentially from industry developed template voting policies).
- An opportunity to input into strategically important vote decisions – e.g., requisitioned resolutions or securities that have been identified as a particular concern (for instance based on the holding size).

The Steering Group supports measures to enhance client voice and is non-prescriptive in suggesting how best to achieve this. Ultimately asset owners and their managers need to implement solutions, expression of wish, that works best for them, fully cognisant of the strengths and weaknesses of the approaches taken.

It is helpful for asset owners to discuss how they are thinking about expressions of wish with their managers in order for managers to assess and respond to client demand. It is important to clarify in each relationship what is meant by an 'expression of wish'. Asset owners should identify this clearly through the RfP and selection process. This will enable managers to determine whether their product offering is suitable for this kind of arrangement. Below we have set out some considerations for both investment managers and asset owners when they are considering making 'expressions of wish' or developing products that facilitate these.

Asset owners should consider the development of 'expressions of wish', alongside other approaches to enhancing client voice as part of their investment and stewardship delegation approach (see above chapter 2).

Where an expression of wish amounts to specifying the importance of certain thematic stewardship priorities, asset owners should consider how to ensure this promotes long-term value. For example, a blanket request to vote in favour of all climate related resolutions could risk, in some instances, supporting management resolutions which are not stretching enough and therefore may not be in the interest of long-term value. As such, asset owners should clearly articulate the policies or priorities driving the expression of wish and how this relates to sustainable value.

Where an expression of wish amounts to asking managers to vote the owners' shares in line with a specific voting policy, in some instances this is more akin to 'directed voting'. As discussed above there are some legal and operational issues with directing voting

in pooled funds. Asset owners will need to consider a wider range of factors to assess how this approach is in keeping with the objective to promote long-term sustainable value and may wish to take legal advice:

- Have they been clear about the intention to set an expression of wish in the RfP/Selection or retendering process? Is the product selection suitable? What are the cost implications of needing to tender a more bespoke service? How does expression of wish sit with the other determinants of the fund's stewardship strategy?
- How they engage with their manager on their expressions of wish? Does the asset owner have the in-house expertise/ resource and governance capacity to develop effective voting policies and review and update them on a yearly basis? How will their investment consultants support with this?
- Where the voting policy is adopted from a third party, what due diligence has been done?
- Are they comfortable with having pre-determined voting policies? Is there flexibility to make a judgment on individual vote decisions based on the managers engagement with the company or the company's explanation as to why a certain approach to governance is appropriate under the UK's comply or explain approach? How will they ensure that individual vote decisions are in the interest of long-term value?
- Are they comfortable with segregating the voting approach to the engagement approach of the manager? How does this impact on the opportunity to influence the company and investment outcomes via leveraging the holdings of the fund at scale? Will they conduct their own engagement to complement this approach?

Considerations for investment managers

- What is the client demand for 'expressions of wish' and how specific are these 'wishes' about voting behaviour in different scenarios? Are they asking for their wishes to be taken into account or followed? Are there better ways of delivering enhanced client voice?
- Do you have the operational capability to allow specific voting policies to be followed? What are the cost implications?
- Is the product offering suitable for client demand? Do the terms and conditions of the fund allow 'expressions of wish' to be taken into account?
- How will the manager consult with different clients on their voting wishes within the same pooled fund? How do they demonstrate they have given due consideration to all clients' views as a part of their responsibilities to 'treat customers fairly'?
- How will the manager report back to the client on how and whether their wishes have been taking into account?

6. OPPORTUNITIES AND BARRIERS TO SUCCESS

We hope the recommendations in this report will provide a strong framework to support more successful investment relationships and more effective collaboration between asset owners and investment managers to achieve sustainable value. We note however that these relationships operate in a complex market and regulatory environment and that the roles and behaviours of several other actors are key to this success. Below we set out a range of barriers and opportunities that should be addressed by the wider market to support.

STEWARDSHIP IN DIFFERENT ASSET CLASSES

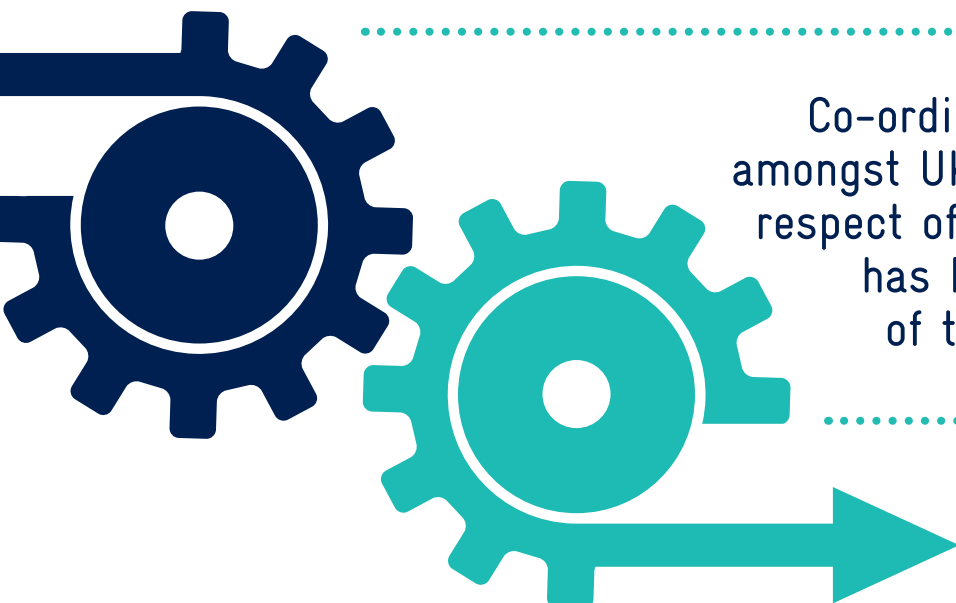
We have noted throughout this report the important role that stewardship plays in the full range of asset classes in which asset owners invest. The role of stewardship in fixed income is of particular importance considering the significant asset allocation from DB pension funds to debt and the significant role that debt will play in supporting the transition to a net

zero economy. The majority of the principles we have discussed are, in essence, asset class agnostic and should be applied across different asset classes.

However, historically the focus on stewardship by the investment industry and regulators has been on the role of voting in listed equity. Market practices for stewardship in fixed income and other asset classes are nascent and it is essential that industry redoubles these efforts to fully integrate stewardship across and within different products and asset classes as per the recommendations of the Asset Management Taskforce.

Financial regulators have an important role to play in supporting a focus on stewardship in fixed income and other asset classes. In addition to supporting market led initiatives, regulators can support this by:

- Ensuring that debt issuers provide the right information to meet investors' needs. The FCA has sought initial feedback on applying climate-related disclosure requirements to issuers of listed debt and debt-like securities. The FCA will continue to engage with stakeholders to gather further input on a proportionate and effective regime, building on the feedback received, with a view to consulting on introducing such a regime at a later stage.
- Ensuring regulatory oversight of asset owners and managers' stewardship responsibilities is not disproportionately focused on listed equity voting.



Co-ordination and co-operation amongst UK financial regulators in respect of stewardship standards has been a welcome feature of the last couple of years.

REGULATORY COORDINATION ON STEWARDSHIP

Co-ordination and co-operation amongst UK financial regulators in respect of stewardship standards has been a welcome feature of the last couple of years. The steering group has particularly welcomed the development of a cross regulatory forum on stewardship in response to the recommendation of the Asset Management Taskforce and their valuable contribution to the work of this steering group. This steering group welcomes continued coordination by different government departments and regulators as the UK embraces initiatives on sustainable finance. We welcome the commitment in the green finance roadmap to support effective sequencing of new sustainability reporting requirements through from investee companies in turn to investment managers and then to asset owners. This sequencing is essential to support the efficient flow of information across the investment chain and supporting effective dialogue between asset owners and investment managers on these disclosures.

Any initiatives to review the vote disclosure requirements for pension funds, in response to the recommendations made by the Taskforce for Pension Scheme Voting Implementation, should also consider the vote disclosure requirements for investment managers and the corresponding regulatory framework. It is important for the FCA and the wider Stewardship Regulators Working Group to work together to ensure reporting requirements mirror each other and support the efficient flow of voting information across the investment chain. The FCA is currently considering options for better standardisation and more timely disclosure of voting information to support information flow along the investment chain – building from the implementation of SRD II and taking into account the recommendations of the TPSVI. The FCA expects to engage further with industry on this matter, also working closely with FRC and relevant Government departments.

We also ask that financial regulators are mindful of the pace of the introduction of new sustainability reporting requirements for pension fund trustees and assess whether these will enable trustees to focus on sustainable value in their relationships with their managers. Excessive focus on granular reporting requirements without a clear rationale for how that information could be used to support better investment outcomes for beneficiaries can serve as a barrier to sustainable investment relationships. This will be a particular challenge for smaller asset owners.

PROGRESS ON VOTE DISCLOSURES

Significant resource has been put into monitoring of voting activities in recent years since the implementation of the Shareholder Rights Directive II. Transparency and accountability on voting activity and how this relates to engagement activity in listed equities is an important component of stewardship reporting. Effective vote reporting should support asset owners to understand how voting rights have been exercised as a part of wider stewardship strategy to enhance long-term returns.

There have been many challenges with providing meaningful and comparable vote reporting. Many of these challenges arise from complexities with reporting of voting across the intermediated investment chain. Pension funds at the end of the voting chain, who may be investing across different mandates, and through intermediated, insured and fund of fund structures are challenged to obtain a holistic view of the voting activity across their portfolios in a timely manner. Further challenges arise where different actors are applying different qualitative assessments of voting information – e.g., using varying definitions of ‘significance’ or applying different labels to categorise votes according to different ESG topics. This is compounded by varying approaches to disclosure from companies and custodians in different geographies.

Achieving better standardisation of vote disclosures would support pension funds and asset managers to meet their regulatory obligations and to make more meaningful comparisons and assessments of how voting is supporting sustainable value. A solution is clearly needed to enable efficient transmission of voting information throughout the intermediated investment chain. The development of such a solution would rely on collaboration of multiple agents across the investment chain and would need to be supported by a streamlined legal framework for intermediated securities. Technological solutions could play a significant role here. We recommend that the Department for BEIS as part of their ongoing work on intermediated securities examines the case for working with different actors across the investment chain to develop a common vote reporting infrastructure. By promoting an industry led solution to vote reporting, this should give more space to market participants to focus on other drivers of long-term sustainable value.



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