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Effective stewardship: Getting the most from your asset managers

Actions to engage asset managers and fulfil your stewardship responsibilities

Over the past year we have seen an increased emphasis on the importance of effective stewardship to deliver returns and real-world outcomes.

2021 saw the first signatories to be successfully listed against the revised UK Stewardship Code. The DWP consulted on guidance to provide greater clarity to trustees on stewardship, following regulated requirements for trustees to detail their stewardship approach in Statement of Investment Principles (SIPs) and Implementation Statements (IS).

Various related consultations and recommendations from initiatives like the Taskforce on Pension Scheme Voting Implementation have sought to strengthen stewardship activity and disclosure.

We expect this focus to continue. We have heard bold statements from government on 2023 becoming the 'Year of the trustee' with greater focus on stewardship activities, and industry discussion on the critical role of stewardship to transition to a low carbon economy.

Against this backdrop, below we provide practical tips for pension funds to engage with asset managers towards better stewardship, followed by a case study example, and general 'starter for 10' questions for trustees with little or no existing engagement.

1 Preparation

Engagement time is most effectively spent using, and building on, existing disclosures and your current understanding of a managers' activities. There has been an explosion of public disclosure from managers in relation to their approach to sustainable finance and associated implementation activities spurred by both more rigorous regulatory requirements and increased expectations from clients. By using information in the public domain, relevant datasets and engaging advisors if needed, you can focus on asking more critical questions that matter to your fund and beneficiaries to glean information that may not be as easily determined from their outward disclosures alone.

Questions should be informed by existing disclosure and your knowledge of the manager in combination with priority ESG themes which you may have identified for the fund. Understanding managers' approach should be referenced against your own priorities and expectations as set out in SIPs and similar policy documents.

A key aim of effective stewardship is to gain insight into a managers' processes and create opportunities to hold them to account where responses are not satisfactory. Ahead of meeting with your manager, be clear on your expectations for the meeting by providing topics for discussion, ensuring the relevant people attend and referencing previous meetings and actions where applicable.

2 Meeting with your manager

Asset managers should provide well-reasoned responses, including:

- A clear understanding of your original question;
- an outline of their policy in this area and an example of how their policy has been applied;
- an indication of the outcomes or impact of their approach, and how they plan to assess this over time.

Unfortunately, some asset managers still provide 'stock' responses that are often insufficient for addressing your original questions. As a responsible asset owner, be on the lookout for unsatisfactory responses which may include:

- Phrases such as "good ESG" or "bad ESG" which indicates a lack of understanding and lip service to the subject;
- general description of their ESG resource, committees and membership of industry organisations;
- generic statements such as, "we have incorporated ESG in our processes" with little further detail as to how;
- voting in line with management or against shareholder resolutions where there is robust rationale and justification (e.g. reference to engagement activity).

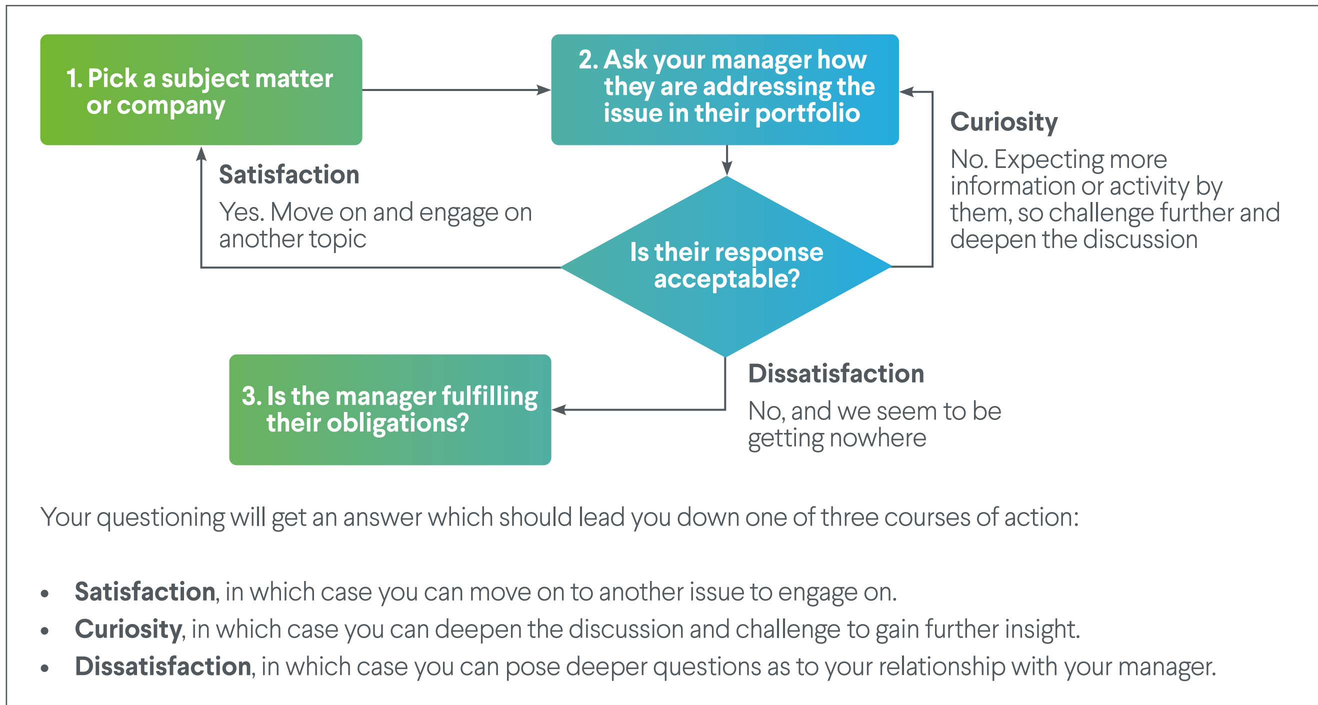
Where responses have not been satisfactory or complete, follow up questions can help you to both:

- Gain deeper insight into managers' processes and approach to stewardship, enabling more effective challenge in future.
- Identify areas for improvement and drive positive change from your asset managers using the weight of assets you have invested with them.
- Inform your assessment of managers' performance against your requirements and expectations.

3 Post-meeting follow-up and further meetings

To ensure continuity and your ability drive issues forward, it is key to record the expectations you have set out in the meeting, this should include aims on what should be achieved with companies and by when. It will also enable you to push for more detailed feedback on the issues you have raised, that will in turn feed back into steps 1 and 2.

Engagement is about holding managers to account on issues that they in turn discuss with companies, the expected outcomes, as well as continual improvement of their own stewardship practices and alignment with your expectations. The chart below illustrates this – how trustees or governance committees should engage with their asset manager(s) on an ongoing basis.



Your questioning will get an answer which should lead you down one of three courses of action:

- **Satisfaction**, in which case you can move on to another issue to engage on.
- **Curiosity**, in which case you can deepen the discussion and challenge to gain further insight.
- **Dissatisfaction**, in which case you can pose deeper questions as to your relationship with your manager.

Examples of starter engagement questions

"How do you use fundamental research and ESG analysis to inform your voting decisions?"

"Which shareholder resolutions have you supported this year and why?"

"Where you reach a decision to vote against management proposals, what steps do you take to ensure management are aware of your reasoning and what follow-up activity do you undertake?"

"Are you satisfied with companies' disclosure against TCFD and approach to transition planning? In which areas have you challenged their approach towards improvement?"

"How do you measure the success of your engagement activity and, where engagements are ultimately unsuccessful, how do you determine what action may then be appropriate? Can you provide some case studies in both instances?"

Please get in touch if you would like to discuss how to engage with your asset manager to address your stewardship responsibilities more effectively.

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Case Study

Asset managers are accountable to trustees and governance committees for the decisions they are taking and are also being paid for this service. It is therefore appropriate that they should be held to account for the proper execution of their stewardship responsibilities given this can impact financial outcomes.

For most pension schemes, some form of manager engagement is a commitment that has been made in the policies that have now been documented. This process need not be complex but is something that trustees or governance committees can do, with help from advisers where appropriate. The case study at the end of this guide illustrates this process.

Case study: Holding an asset manager to account on stewardship

Our client is an £800m pension scheme with an ambition to embrace responsible investment considerations. Having helped the trustees develop their formal responsible investment policy, which included a focus on sustainable investment and an active approach to stewardship, the trustees identified that engagement has a key role to play in promoting long-term value. As a means of providing focus, the trustees have concentrated on two key themes: climate change and executive remuneration.

We provide the trustees with quarterly updates on their asset managers' voting and engagement activities to support their ongoing stewardship. These are used to test the extent to which the asset managers' approaches are aligned to the trustees' policy, with focus on climate risk and executive remuneration as key issues as part of this process.

Through this review process, the trustees noted several examples where one of their asset managers consistently voted against proposals to address issues relating to climate change, or excessive executive remuneration policies. In contrast, their other manager voted differently in each of these instances, with the supporting rationale in this case aligned with the trustees' expectations. These differing positions formed the basis of deeper engagement with and challenge of the asset managers' activity. This identified the first manager's underlying rationale was to pursue ongoing engagement with investee companies, rather than vote shares against management.

The trustees were ultimately dissatisfied with the approach adopted by the investment manager, the poor explanations of decision making and the level of transparency demonstrated. The trustees agreed to formally write to the manager, setting out their position and ensure they were holding their manager to account.

Continued monitoring highlighted further instances of similar practices from the manager, and no measurable change in their stewardship approach. Given the existence of credible alternatives, we advised the trustees to review the manager's longer-term role in managing assets for the Scheme.

We recommended that the trustees reduce the manager's mandate and allocate the assets to another manager with a policy more closely aligned with that of the trustees. Combined with this, we established clear measures for improvement for the existing manager to deliver over the course of the next 12 months. This included demonstrating progress in relation to their stewardship approach in areas such as transparency and reporting.

Depending on the progress made over the course of the next 12 months, the trustees will decide whether to continue with this programme of active engagement and monitoring or replace the manager. This case study demonstrates our belief that asset owners can:

- actively engage with and challenge their investment managers, even when monies are invested in pooled funds;
- concentrate on particular issues as a means of focusing engagement activity and embed this into a regular manager oversight programme; and
- use stewardship as a means of differentiating between managers.

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