A HOLISTIC APPROACH TO STEWARDSHIP

Effective stewardship is about much more than simply signing up to the latest collaborative initiative or casting a vote at an AGM. In fact, poorly considered and reactive stewardship practices can be counter-productive, leading to frustration for both companies and investors.

For schemes to be effective stewards of their assets, they must work with their advisers to proceed step-by-step along their stewardship journey. For most schemes, this will mean:

- Working through the scheme's investment strategy, policy and objectives
- Developing and agreeing upon trustee investment beliefs
- Deciding the role both stewardship and the integration of ESG factors play within this framework
- Considering what constitutes an appropriate engagement strategy and plan
- Formulating an approach or policy for voting decisions
- Communicating expectations to service providers
- Monitoring and holding asset managers and others to account
- Assessing managers' stewardship commitment
- Monitoring how votes are cast by fund managers in the interests of the scheme
- Measuring and reporting on stewardship outcomes by fund managers.

We created the checklists below to guide schemes through these steps. Readers should note that this section does not aim to be a complete and prescriptive guide to stewardship. Instead, we seek to offer up key issues for investor consideration and articulate which of the various aspects of voting and engagement trustees should consider as part of their broader stewardship approach.

PLSA STEWARDSHIP CHECKLIST

To ensure an effective and meaningful stewardship strategy, scheme investors should consider the following policies, compiled using the PLSA and The Investment Association's 2022 recommendations.[13]

OVERALL POLICY AND APPROACH

- Be clear about how stewardship fits within a company's investment strategy, policy and investment objectives. This should include:
  - A clear and agreed upon understanding of the trustee board and the relevant organisations' (e.g. the employers') overall mission, purpose and objectives.
  - A defined set of agreed upon investment beliefs – including on ESG issues – at a level which ensures everyone is comfortable, but which is also sufficiently granular to meaningfully inform and guide the investment strategy and objectives.

[13] Pensions and Lifetime Savings Association & The Investment Association, 'Investment Relationships for Sustainable Value Creation: Alignment Between Asset Owners and Investment Managers' Pensions and Lifetime Savings Association & The Investment Association (2022) <https://www.plsa.co.uk/Portals/0/Documents/Policy-Documents/2022/Investment-relationships-for-sustainable-value-creation-July-2022.pdf>.

    - A robust framework for deciding and monitoring a scheme's investment policies – including on ESG issues – and the role which acting as an engaged steward of members' assets plays in this. This can either be a standalone policy or fully integrated into a scheme's investment policies.
    - A strategy for how stewardship fits into the manager selection process and ongoing relationship monitoring. This should include an assessment of culture and values, placing greater value on stewardship alignment in the selection process, an assessment of stewardship incorporation in the whole investment process and an assessment of asset managers capacity to meet evolving expectations.
- Work with advisers to consider the level of resources available for stewardship activities, which assets are covered and what an appropriate structure may be. Some schemes have the resources for an in-house stewardship team. Others need to outsource stewardship either to their existing asset manager or to a specialist stewardship 'overlay' provider. It should be noted that delegating stewardship activities does not absolve schemes of responsibility.
- Assess what stewardship arrangements are already in place and whether they remain fit for purpose. Schemes should not be afraid to challenge their existing service providers, including asking for practical examples of stewardship activities and outcomes.
- Decide what strategic issues – including ESG factors – are most material to the scheme. This decision is likely to be taken in consultation with both investment and legal advisers, as well as with employers, including any in-house sustainability or Corporate Social Responsibility professionals. It could also include engagement with members to ascertain their views, although there should be clear communication that it is the trustees who retain the primary responsibility for investment decisions.
- Have a clear policy on what kind of stewardship tools will be employed. This could include individual investor engagement, exercise of voting rights, collaborative engagement efforts or divestment. This should also include well-defined criteria for the escalation of engagement.
- Outline a clear plan regarding how investment managers will employ these tools. For instance, how they will vote on certain matters (where possible) and through what means (i.e. directly, delegated to their asset manager or through a specialist overlay service).
- A voting policy is a particularly helpful tool for schemes, enabling schemes to set out their views on a range of corporate governance, environmental and social issues so it can be used as a tool for discussion and communication with asset managers, companies and their consultants.
- Consider participating in public policy dialogues. Investor stewardship takes place within a policy and regulatory framework that is shaped by several forces. Where investors feel that the legislative framework does not sufficiently support them, they should seek to influence policy and regulatory initiatives. Those investors with fewer resources could consider joining their voice with others, for instance through membership bodies or targeted collaborative initiatives.

HOLDING SERVICE PROVIDERS TO ACCOUNT

- Seek to ensure that fund managers and other service providers deliver effective integration of their stewardship policy objectives as well as long-term ESG factors into their investment approach. Schemes should ensure that these approaches are fully consistent with their investment strategy, policy and objectives over the appropriate time horizon.
- Explicitly set out expectations for outsourced stewardship activities in legal documents. The most effective way of ensuring asset managers and other service providers are held to account on their stewardship work is to ensure expectations are clearly set out in legal documents such as the Investment Management Agreement (IMA).
- Agree to a schedule for monitoring and reviewing outsourced stewardship activities. Working with advisers, scheme investors should consider how and when to scrutinise their asset managers' stewardship and engagement activities on their behalf. This should include during manager selection (and RFPs), but an annual stewardship activity review would also be good practice.

OTHER

- Sign up to, or follow best practice guidance from, the FRC's Stewardship Code or other equivalent Codes in other jurisdictions. Asset owner signatories to the Stewardship Code must demonstrate their commitment to the Code's spirit and communicate how they adhere to its principles to enhance and protect long-term value for scheme members.
- Agree to a policy and approach for the communication of stewardship activities to stakeholders. This should include communication with regulators and members. Disclosure is required in schemes' SIPs and Implementation Statements and in TCFD reports where relevant. Schemes could also consider including this information in the annual DC Chair's statement or in a standalone Stewardship or Responsible Investment Report.

COLLABORATIVE ENGAGEMENT

The 2020 Stewardship Code defines collaborative engagement – often used interchangeably with the term collective engagement – in two ways: as a collaboration with other investors to engage an issuer to achieve a specific change, and as working as part of a coalition of wider stakeholders to engage on a thematic issue.

There are several different activities or tactics that investors can use collectively to ensure effective engagement, including: informal discussions with investors or companies; private or public letters; specific engagements with a company; or a formal agreement or initiative (including specific objectives, timescales, and strategies).

The PLSA believes that collaborative engagement can be helpful for asset owners to make the most of limited stewardship resources or AUM. Effective collaborative engagement for scheme investors has clear, well-targeted and time-specific objectives that are explicitly linked to improving and protecting the value of scheme members' savings. It will also set out clear legal boundaries and the delineation of responsibilities for those leading or participating.

Schemes should ask their advisers and asset managers at both selection and review sessions what collaborative engagement activities they have taken part in, including their objectives, impact, outcomes and what role they have played. Collaborative relationships between asset managers and investors should be built on a long-term basis and in a such way that they can evolve over time. This approach will be key in addressing systemic risks including sustainability challenges.[14]

PLSA ENGAGEMENT CHECKLIST

It is clear that stewardship is about more than just voting, but also engagement. The FRC recognises this in its Stewardship Code, as does DWP in its 2018 changes to the Occupational Pension Schemes Investment Regulations 2005, which also broadened the definition of stewardship to include engagement. In fact, engagement is perhaps the primary means of effecting an investor's stewardship responsibilities. To ensure an effective engagement strategy that results in purposeful dialogue, investors should:

- Decide the key issues for engagement. This should include financially material ESG topics. Any decision should be taken in consultation with the employers, legal and investment advisers, as well as potential engagement with members.
- Agree how engagement will be used. This should include whether the scheme will engage directly with key companies on certain issues or whether such activity will be delegated to fund managers. It should also include an assessment of whether to engage with policymakers to raise awareness of an issue more generally or to alter the regulatory framework.
- Agree a process for deciding what 'success' looks like. This should include documented decisions on issues such as what level of change is being sought and over what timescale, and at what stage an investor should decide to escalate its engagement. Examples of escalation include issuing a public statement, filing a shareholder resolution or collaborating with other investors or campaign groups, if these are not already a part of the engagement process.
- Be open to engagement with companies on the full range of substantive matters. Investors should also be clear about their investment objectives when engaging with a company, so the Chair and Directors are better able to understand what is expected of them. They should also make it clear to a company on whom decisions on both investment and voting rest.
- Work to ensure companies genuinely feel that there is scope for explanations as well as compliance with the Corporate Governance Code and other requirements. Where the views of boards and their shareholders differ on matters of corporate governance, constructive discussion should follow. However, schemes should ultimately be prepared

[14] Pensions and Lifetime Savings Association, Chartered Institute of Personnel and Development and Railpen,'How Do Companies Report On Their 'Most Important Asset'?' Pensions and Lifetime Savings Association, Chartered Institute of Personnel and Development and Railpen (2022) <https://www.plsa.co.uk/portals/0/Documents/Policy-Documents/2022/How-do-companies-report-on-their-most-important-asset-Mar-22.pdf>.

to exercise their rights to do what they see as necessary to protect the interests of their beneficiaries.

HOLDING SERVICE PROVIDERS TO ACCOUNT

According to a PLSA and The Investment Association report on sustainable value creation, best practices should include:[15]

- Take time to understand a service provider's approach to engagement, including when the asset manager or provider decides to engage, how they apply voting sanctions and how the two fit together. This should cover the entirety of the investment process and the different asset classes in which they invest.
- Explicitly set out expectations for outsourced engagement activities in legal documents, such as the IMA or a 'Governing Charter'.
- Agree to a schedule for monitoring and reviewing outsourced engagement activities, which should align with the performance review cycle, investment and stewardship objectives and Key Performance Indicators (KPIs), while including quantitative and qualitative reporting.

OTHER

- Consider taking part in collaborative engagement initiatives, which can be a powerful way of effecting change at companies on issues of shared interest. Collaborative engagement is also one of the few ways in which shareholders and bondholders can come together across different investment houses on the same issues.

THE ROLE OF VOTING IN GOOD STEWARDSHIP

How an investor casts its vote at a company AGM can be a powerful statement of either satisfaction or dissatisfaction with the approach of company management on specific issues. An effective stewardship approach is likely to be one which is backed up, where necessary, by voting sanctions.

THE ANNUAL GENERAL MEETING

At an AGM, company Directors 'present' their annual report to shareholders. Shareholders also get the opportunity to ask questions as well as to express their views on issues of concern such as executive remuneration, business strategy or climate risk.

The AGM is an important part of the dialogue between a company and all its shareholders and is the occasion at which the board is held accountable for its actions during the preceding year. Shareholders should therefore make every effort to register their votes after careful consideration of the resolutions on the agenda.

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[15] Pensions and Lifetime Savings Association & The Investment Association, 'Investment Relationships for Sustainable Value Creation: Alignment Between Asset Owners and Investment Managers' Pensions and Lifetime Savings Association & The Investment Association (2022) <https://www.plsa.co.uk/Portals/0/Documents/Policy-Documents/2022/Investment-relationships-for-sustainable-value-creation-July-2022.pdf>.

Attending and speaking at the AGM is an effective way of expressing views about the company, not least when concerted attempts at engagement have failed to achieve a satisfactory resolution. It is also a good opportunity to hear the views of other shareholders, including retail investors whose opinions are not otherwise widely heard.

Investors should expect boards to articulate clearly in their documents how they oversee and manage all material risks to their business model, approach and strategy. This helps investors form judgements on the management of these issues, informing their understanding of the effectiveness of the board oversight and guiding their approach to resolutions at the AGM.

Should an investor decide to vote against or abstain on a particular resolution, they should seek to explain to the company the reasons for doing so as early as possible.

Companies should publish AGM results as soon as possible after the meeting and should include in this a record of votes withheld. Where 20% of the votes on a particular resolution have not been registered in support of management (meaning both votes against and active abstentions) the board should acknowledge this within its Regulatory Information Service (RIS) statement and communicate as soon as reasonably possible how it intends to engage with shareholders to understand the reasons for this dissent.

The company should then explain within the following year's Annual Report and Accounts the steps it has taken, or will be taking, to resolve those concerns.

- While companies must avoid boilerplate explanations and provide thoughtful and justifiable explanations for any areas of non-compliance, shareholders also have a responsibility to:
  - Evaluate explanations in an intelligent and non-mechanistic way for non-compliance by companies against the Stewardship Code.
  - Take account of a company's individual circumstances.
  - Engage as appropriate, making sure that companies are aware of the reasoning behind a given vote on a contentious issue – often it is only through engagement that an investor can dig down more deeply into an issue of concern.
  - Ensure that voting decisions are always made in the context of a company's overall governance arrangements and consider the progress made, given that governance is always dynamic.

PLSA INVESTOR VOTING CHECKLIST

There are several steps that investors can take to ensure they use their vote to wield maximum influence. These include to:

- Establish a clear process for voting. Working with advisers (and referring back to the scheme's investment objectives, stewardship beliefs and engagement approach), investors should consider what issues will be considered when deciding how to cast their vote. Articulate an approach through formulating a voting policy on key issues, which should set out the approach to exercising voting rights. Consideration should also be given as to whether this should be published online, giving full access to the general public.

- Consider using the full set of voting powers to support the highest standards of governance. Powers which have historically been used more rarely include the approval of the Annual Report and Accounts, the appointment or reappointment of Auditors, attending and speaking at AGMs and tabling shareholder resolutions.
- Be prepared to escalate when necessary. Investors should be ready to escalate – including holding individual Directors responsible - in instances where it is clear that a given company is repeatedly failing to respond meaningfully to investors' concerns on a specific issue. However, investors should always balance the "signalling" effect of a voting sanction against the potential for it to exacerbate the situation which they seek to remedy.

HOLDING YOUR SERVICE PROVIDERS TO ACCOUNT

- Set clear expectations with asset managers on how you want your vote to be considered and cast in pooled funds. A manager's approach should be a key issue when selecting a manager or deciding whether to invest in collective investment vehicles or nominee accounts (pooled funds). Schemes should be asking their manager to explain their approach to voting and what input is gathered from schemes in order to cast a particular vote.
    - If an asset manager does not allow for split voting in their fund, schemes should ask to see the asset manager's voting policies across the scheme's key financial considerations and their investment beliefs and objectives. If possible, this information should be provided on a fund level as opposed to the manager-wide level.
    - Schemes should also ask fund managers to evidence how the relevant ESG criteria have been applied in voting decisions.
- Outline expectations regarding securities lending, including appropriate expectations and processes outlined in legal documents for asset managers, custodians and other service providers.

OTHER

- Consider how you communicate your voting activities in required disclosures. This includes within your SIP and implementation statement. Scheme investors should work with their advisers and asset managers to ensure that they have a clear and consistent view of what is meant by a "significant" vote, making use of the PLSA Voting Reporting Template where necessary. Schemes should also consider the potential benefits of publishing – and making publicly available – their voting policy.

SECURITIES LENDING

Securities lending refers to the act of temporarily transferring securities from a lender to a borrower. Securities lending can provide benefits to the lender (including institutional investors), enabling schemes to generate low risk but small returns on their portfolios.

However, securities lending also results in a temporary transfer of ownership, which includes voting rights, to the borrower. Principle 12 of the 2020 UK Stewardship Code states that signatories must “actively exercise their rights and responsibilities” when it comes to securities lending. Investors must therefore consider carefully how a securities lending policy might fit in with their stewardship approach, including effective exercise of voting rights.

Scheme investors’ expectations of their asset managers and custodians regarding securities lending should be set out clearly in relevant legal documents like the IMA. Details covered should include under what circumstances a manager will recall stock (as well as the timescales for this) and whether the manager or custodian has a policy to temporarily suspend lending in a particular share ahead of a forthcoming vote, rights issue or other corporate action.

Asset owners might have a separate securities lending relationship with the custodian, and the asset manager may be unaware of this relationship, so it is important for schemes to work with their advisers to understand the nature of the contractual and practical relationships around securities lending.

VOTING IN POOLED FUNDS

Schemes in the UK have historically been more used to segregated arrangements than their counterparts elsewhere in Europe. However, with a shift towards greater diversification and complexity of investments, pooled vehicles have been growing in popularity amongst schemes of all sizes.

While pooled arrangements can offer access to greater diversification and often (but not always) bring benefits in terms of lower costs, there are several issues to be considered. One of which is the level of influence the scheme has over how its voting policy and preferences are exercised.

When thinking about choosing a manager of a pooled vehicle, schemes should make sure they get full details of the manager’s voting policy – if it is not already publicly available – and ask for case studies regarding how the manager has exercised its influence through votes to impact a particular outcome.

Schemes should make sure their expectations are clear to managers, including proactive engagement with the manager on issues that arise. For those managers who are Stewardship Code signatories, schemes should ask how they have reported in alignment with the Code expectation that fund managers explain their approach to allowing clients to direct voting.

Schemes should also ask for a regular voting report as part of the manager’s responsible investment report (ideally issued to trustees on at least a half-yearly basis) and be prepared to address any concerns with their asset managers which might have arisen about specific aspects of the asset manager's voting actions.

Schemes should be prepared to consider changing asset managers if their concerns are not addressed over a reasonable time period, or if they feel that their approach to voting and their managers are not sufficiently aligned.