NAPF STEWARDSHIP POLICY

NAPF
Securing the future of pensions

Introduction

Members of the National Association of Pension Funds (NAPF) have a clear interest in promoting the long term success of the companies in which they invest. For this reason we have since its launch in 2010 been a strong supporter of the UK Stewardship Code.

The informed use of votes, while not a legal duty, is a responsibility of owners and an implicit fiduciary duty of pension fund trustees and investment managers to whom they may delegate this function. Effective engagement with companies on issues ranging from strategy and performance to risk and corporate governance can a) protect funds against **reputational risk** and b) play a key role in **controlling investment risk;** helping guard the fund against potential destruction in shareholder value.

Despite the considerable efforts made by many pension funds, perceptions remain that funds are failing in overseeing the activities of their investment managers and other agents to whom most delegate the responsibility for engagement and voting.

In light of recent revisions to the Stewardship Code and increasing political focus on the issue the time is right for pension funds to review their approach to Stewardship, question whether it could be more effective and consider how they should adopt the Stewardship Code requirements.

Actions

The Stewardship Code states that the primary responsibility for stewardship – active monitoring of and engagement with companies - lies with the asset manager. However, there are **three simple actions** which can be expected of pension funds as the owners and providers of capital:

1. Include a section on ‘stewardship’ within the fund’s Statement of Investment Principles.
2. Include stewardship criteria in manager searches
3. Incorporate monitoring of stewardship activities into manager reviews

“Signing up”

“Signing up” to the Code demonstrates that a pension fund believes companies should adhere to the highest standards of governance and that their managers should integrate the Code’s Principles into their investment processes.

A growing number of asset owners have signed up to the Stewardship Code since its introduction and we encourage others to follow suit. A greater weight of pension fund signatories to the Code will further influence behavioural changes that lead to better stewardship by asset managers and companies.

There is good evidence that poor corporate governance practices are detrimental to the interests of long-term investors. Therefore part of the fiduciary duty of trustees is to take appropriate action if there are concerns about corporate governance or other non-financial risks within companies in which they are invested which may cause loss to shareholder value. As such **it is wholly in line with trustees’ legal duties to support active stewardship** of their funds either directly or indirectly via their manager and/or a third party.

To assist funds in ‘signing up’ to the Stewardship Code we have produced an **Implementation Questionnaire** which provides a framework which funds may wish to complete and submit to the FRC as a means of demonstrating their commitment to the Code.

In addition, we have provided a **short guidance document** which sets out the Code’s seven Principles, along with suggestions as to how funds may consider applying them. Funds may wish to utilise this when making their disclosures under the Code.

Regulatory Evolution

- **SRI Pensions Disclosure Regulation** (2000) - required trustees to disclose in their Statement of Investment Principles (SIPs) the extent (if at all) social, environmental or ethical (SEE) considerations are taken into account in investment decisions; and their policy in relation to the exercise of the voting rights.
- **Myners Review** (2001) **-** recommended that funds have a policy for shareholder activism and the subsequent Myners principles set out best practice for institutional shareholders.
- The updated **2008 Myners Principles** indicated that trustees should include a statement of the scheme's policy on responsible ownership within its SIP and adopt or ensure their investment manager adopts the ISC Code on the Responsibilities of Institutional Investors.
- **UK Stewardship Code** (2010) - replaced the ISC Statement of Principles and set out good practice on engagement with investee companies. The FRC made clear the responsibility for monitoring company performance does not rest with fund managers alone (this was clarified further in the 2012 Code revisions).
- **United Nations Principles for Responsible Investment** (UN PRI) - launched in 2006 and has become the benchmark for global best practices in responsible investing. It now has over 1,000 investment institutions, including 262 asset owners, as signatories, with assets under management of approximately US$ 30 trillion.
- **In 2012**, politicians have suggested pension funds should support **"responsible capitalism"** as engaged investors. Pending regulation in the UK and EU supports enhanced shareholder rights and responsibilities to improve oversight of companies.

NAPF PRINCIPLES FOR STEWARDSHIP BEST PRACTICE

PENSION FUND TRUSTEES SHOULD……

1. Act at all times in the best long-term interests of the fund's beneficiaries.

Funds should seek to act as responsible owners and ensure their policy for dealing with conflicts of interest also covers investment matters such as voting.

2. Develop an investment policy which includes an understanding of stewardship objectives and risks.

This policy should encourage the incorporation of material non-financial risks, including corporate governance factors, within investment decisions and the exercising of stewardship responsibilities such as engagement and voting – to be set out within the funds' Statement of Investment Principles (SIP).

3. Set mandates for asset managers which explicitly include Stewardship

Day to day responsibility for stewardship can be delegated, but investment managers' stewardship capabilities and policies should be a factor in manager selection and relevant criteria should be included within RFPs.

Mandates should encourage integration of corporate governance and other material non-financial risks into investment decision-making; align interests through fees and pay structure; ensure adherence to high standards of stewardship and provide for useful and transparent reporting to the fund.

4. Encourage and empower asset managers to engage with investee companies as a means of improving company performance to deliver investment returns

Funds should encourage collaboration between investment managers as a means of more effective engagement and voice. They should be clear about their managers' approach and should expect a report on such collaboration.

5. Review investment performance no more frequently than is necessary, and with reference to long-term absolute performance.

Within the regular manager reviews, funds should ensure that managers are adhering to the funds' stewardship policy. This may include questioning the effectiveness of managers' engagement activity and how they plan to engage with key holdings which have performed poorly over a period of time.

6. Provide information on Stewardship to beneficiaries, in a way which is clear and timely.

Trustees should endeavour to report annually to fund members on their stewardship policy and illustrate how it has been implemented in the past year and how its managers aim to address failings with investee companies in the coming year.

Stewardship Code Implementation Questionnaire for Pension Funds

This questionnaire is designed to help pension funds to discharge their stewardship duties by providing a framework for disclosing their commitment (or otherwise) to the Stewardship Code. Funds may wish to complete and submit this document to the FRC as a means of demonstrating their commitment to the Code.

Funds are encouraged to refine their approach and have this reflected accordingly in the answers to the below.

Whilst the questionnaire is designed for simplicity, there are various sections throughout the form which ask for comments/details. Funds are strongly encouraged to provide as much detail in these sections as possible to enable the reader to understand the context under which the fund's stewardship practices apply.

Contact details	
Fund Name:	
Contact Name:	
Position:	
Email:	
Telephone:	

Principle 1:	**Institutional investors should publicly disclose their policy on how they will discharge their Stewardship duties.**
Question 1:	Has the fund chosen to commit to the UK Stewardship Code? ☐ Yes ☐ No If you answer **NO**, please explain why and/or explain any alternative investment strategy (as may be required under the FSA rules): ***This is the end of the questionnaire for those funds which have chosen not to commit to the UK Stewardship Code.***
Question 2:	Which approach has the fund adopted for stewardship? ☐ The delegated model (delegated to asset managers) ☐ The in-house model (managed internally) ☐ The outsourced model (using a third-party specialist service) ☐ A hybrid approach (partly internally managed and partly outsourced) *Please give details of your approach:*
Question 3:	Has the fund agreed and published a policy on how it will discharge its stewardship responsibilities? ☐ Yes ☐ Agreed, but not yet published ☐ No – please explain why:
Question 4:	Has the fund included its policy on stewardship (or does it intend to) within its Statement of Investment Principles (SIP) Please select all that apply. ☐ Yes ☐ No, but it is published elsewhere on the fund website ☐ No. but it is included within our annual report ☐ Other – please specify: ☐ Not applicable
Question 5:	To which asset classes does the fund's policy on stewardship apply? ☐ Listed UK equities ☐ Listed international equities ☐ Bonds and other fixed income investments ☐ Property ☐ Alternative assets ☐ Other – please specify:
Question 6:	Please add any further comments on how your scheme applies Principle 1 including any explanation for non-compliance:

Principle 2:	Institutional investors should have a robust policy on managing conflicts of interest in relation to stewardship and this policy should be publicly disclosed.
Question 1:	Does the fund have a process for managing conflicts of interest which is publicly disclosed? ☐ Yes (please cite where it is disclosed) ☐ No, but it is available on request ☐ No
Question 2:	Does the fund monitor its external asset managers' process for managing conflicts of interest? ☐ Yes ☐ No ☐ Not applicable (no external asset managers)
Question 3:	Does the fund monitor its investment consultant's process for managing conflicts of interest? ☐ Yes ☐ No ☐ Not applicable (no asset consultant)
Question 4:	Please add any further comments how your scheme applies Principle 2 including any explanation for non-compliance:

Principle 3:	Institutional investors should monitor their investee companies.
Question 1:	The fund monitors its investee companies by: ☐ Outsourcing monitoring to asset managers ☐ Outsourcing to another third party ☐ Undertaking direct engagement with companies ☐ The fund does not monitor investee companies
Question 2:	Does the fund oversee their managers' compliance with the agreed policies? ☐ Yes, we receive a regular monitoring report. ☐ Yes, we question our investment managers on high profile cases during manager reviews ☐ No
Question 3:	Please add further comments on how your scheme applies Principle 3 including any explanation for non-compliance:

Principle 4:	Institutional investors should establish clear guidelines on when and how they will escalate their activities as a method of protecting and enhancing shareholder value.
Question 1:	Does the fund have its own policy or guidelines on when and how they will escalate their activities as a method of protecting and enhancing shareholder value? ☐ Not applicable (this function is outsourced to the asset manager) ☐ Yes – please cite if/where it is disclosed: ☐ No
Question 2:	Please add further comments on how your scheme applies Principle 4 including any explanation for non-compliance:

Principle 5:	Institutional investors should be willing to act collectively with other investors where appropriate.
Question 1:	Does the fund undertake collective engagement? ☐ This function is outsourced to the asset manager ☐ This function is outsourced to a third party ☐ Yes ☐ No
Question 2:	Please add further comments on how your scheme applies Principle 5 including any explanation for non-compliance:

Principle 6:	Institutional investors should have a clear policy on voting and disclosure of voting activity.
Question 1:	Does the fund have its own voting policy? ☐ The fund applies the NAPF's Corporate Governance Policy & Voting Guidelines ☐ This function is outsourced to asset managers

	☐ Yes ☐ No
Question 2:	Does the fund delegate any voting to its asset managers? ☐ Yes, all voting is delegated to asset managers ☐ Yes, some voting is delegated to asset managers ☐ This function is outsourced to the proxy voting agency or another third party ☐ No
Question 3:	If voting is outsourced to an asset manager, does the fund monitor the voting activity of its managers? ☐ Yes ☐ No
Question 4:	Does the fund disclose information on voting? ☐ Yes both voting policy and voting activity– please cite where it is disclosed: ☐ Just voting policy – please cite where it is disclosed: ☐ Just voting activity– please cite where it is disclosed: ☐ Not currently, but intends to do so – please note from when: ☐ This function is outsourced and information can be found here: ☐ No
Question 5:	Does the scheme have a policy on stock lending? ☐ Yes ☐ No
Question 6:	Please add further comments on how your scheme applies Principle 6 including any explanation for non-compliance:

Principle 7:	**Institutional investors should report periodically on their stewardship and voting activities.**
Question 1:	Does the fund review its internal and/or external asset managers' stewardship reports and if so how often? ☐ Yes, Quarterly ☐ Yes, Annually ☐ Yes, Every 2 – 3 years ☐ No, Never
Question 2:	Does the fund make such reports available to members? ☐ Yes ☐ No
Question 3:	Does the fund make these publicly available? ☐ Yes – please cite where it is disclosed: ☐ No
Question 4:	Does the fund require verification of the asset managers' engagement and voting processes? ☐ Yes, we require formal certification – e.g. AAF01/06 - of asset managers' activities ☐ Yes, we require internal audit (but not formal certification) of asset managers' activities ☐ No
Question 5:	Please add further comments on how your scheme applies Principle 7 including any explanation for non-compliance:

General comments
Do you have any further general comments on the Stewardship Code and how you apply its Principles, :

Please email the completed Stewardship Code Implementation Questionnaire to: stewardshipcode@frc.org.uk

NAPF Contacts (for general queries and an electronic version of the Questionnaire)

David Paterson Head of Corporate Governance David.Paterson@napf.co.uk	Will Pomroy Policy lead: Corporate Governance Will.Pomroy@napf.co.uk

Guidance for pension fund application of the Stewardship Code

Committing to the Code may seem complex or at first sight perhaps not directly relevant to smaller funds. However, while funds may outsource to others many of the activities associated with stewardship, they do not delegate their responsibility for stewardship. In addition size alone is not seen as an impediment to effective application of the Code, as smaller funds usually delegate investment management to a third party, which should be competent to meet the requirements of the Code.

A fund's commitment to the Code may include engaging directly with companies or more likely indirectly through the mandates given to their investment managers. They should clearly set out their policies on stewardship to their managers and seek to hold them to account for their stewardship activities. In so doing, they better fulfil their duty to their beneficiaries to exercise stewardship over their assets.

We set out below the Code's seven Principles, along with suggestions as to how funds should apply them. Funds may wish to utilise this when making their disclosures under the Code. We have particularly focussed on those funds which delegate investment management to a third party.

Principle 1: Institutional investors should publicly disclose their policy on how they will discharge their stewardship responsibilities.

Pension funds should include within their Statement of Investment Principles (SIP) their policy in relation to the exercise of stewardship responsibilities such as engagement and voting as well as the extent to which non-financial factors including corporate governance should be incorporated within investment decisions.

A detailed policy description should be provided by the funds' investment managers and this should be consistent with the funds' own stewardship policy.

Trustee question: Do we have a clear policy which is incorporated into our investment management agreements and/or Statement of Investment Principles?

Principle 2: Institutional investors should have a robust policy on managing conflicts of interest in relation to stewardship which should be publicly disclosed.

Trustees will already have a policy in relation to conflicts of interest, which should be extended to cover investment matters. They should have an explicit policy for dealing with conflicts with the sponsor(s) which may arise over corporate governance or voting.

Likewise funds' investment managers should clearly state in their investment management agreement how they propose to address conflicts. Both should agree at the start which issues, if any, are reserved for the decision of the trustees.

Trustee question: How do we address conflicts of interest which may arise from stewardship issues?

Principle 3: Institutional investors should monitor their investee companies

For those funds which delegate investment management to third parties, a monitoring report should form an integral part of the regular reporting material which they receive from their advisers or agents. Funds should not be expected to duplicate the work of their investment managers, but it is the trustees' responsibility to ensure that sufficient time is given to overseeing their managers' compliance with the agreed policies.

Trustee question: How effectively and regularly do our managers monitor companies in which they've invested?

Principle 4: Institutional investors should establish clear guidelines on when and how they will escalate their stewardship activities.

This again is a matter for contractual agreement between the fund and its investment manager. Funds should be aware of when concerns have been escalated in the way envisaged in the Code and understand how their interests have been protected as a result.

Trustee question: Can our managers cite examples of escalation of their concerns, and what happened?

Principle 5: Institutional investors should be willing to act collectively with other investors where appropriate.

Funds should encourage collaboration between investment managers as a means of more effective engagement. They should be clear about their managers' approach and should expect a report on such collaboration. The NAPF also supports more direct involvement by funds in such efforts where the presence of the end-owner of the stock may add weight to the arguments and ensure that their views are properly conveyed to the company concerned – the NAPF is happy to help facilitate such engagement.

Trustee question: Are our fund managers committed to collaborating with others, when appropriate?

Principle 6: Institutional investors should have a clear policy on voting and disclosure of voting activity.

Funds are expected to state their voting policy and summarise their voting activity to members. While there is no value in boiler-plate reporting it is clear that there is growing support for improved disclosure – indeed many funds and their managers already provide a good standard of public disclosure. Funds should be clear and be able to communicate that their votes have been exercised and how so in the more contentious instances.

Trustee question: Does the fund have a voting policy whose application is clear from the reports produced?

Principle 7: Institutional investors should report periodically on their stewardship and voting activities.

For funds, we recognise that there are significant practical problems around disclosure, but encourage them to report annually to their members, setting out the key voting issues during the year and how the fund's managers addressed them. Each year there are several meetings which are especially important and worthy of comment. Such an approach demonstrates that there is effective monitoring of the investment managers.

Given the size of most portfolios it is not practical to expect the manager to report on each stock held, nor necessarily of interest, but we expect investment managers' reporting to trustees to demonstrate not only that procedures are in place covering engagement and voting, but also how effective the engagement activity has been in protecting their client's interests. For example how do they plan to engage with key holdings which have performed poorly over a period of time.

Trustee question: How effective is communication with investment managers, and thereafter to members, on engagement?