PENSIONS AND
LIFETIME SAVINGS
ASSOCIATION

THE INVESTOR FORUM

ENGAGING THE ENGAGERS

A PRACTICAL TOOLKIT FOR SCHEMES TO ACHIEVE EFFECTIVE STEWARDSHIP THROUGH THEIR MANAGERS

JULY 2020

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THE PENSIONS AND LIFETIME SAVINGS ASSOCIATION

Our mission is to help everyone achieve a better income in retirement. We work to get more people and money into retirement savings, to get more value out of those savings and to build the confidence and understanding of savers.

We represent the defined benefit, defined contribution, master trust and local authority pension schemes that together provide a retirement income to 20 million savers in the UK and invest £1 trillion in the UK and abroad. Our members also include asset managers, consultants, law firms, fintechs and others who play an influential role in the governance, investment, administration and management of people's financial futures.

THE INVESTOR FORUM

The Investor Forum's purpose is to position stewardship at the heart of investment decision-making by facilitating dialogue, creating long-term solutions and enhancing value. It was formed by the investment community in 2014, in response to the call in the Kay Review of UK equity markets and long-term decision-making for the creation of an investors' forum "to facilitate collective engagements by UK investors in UK companies". The Investor Forum works collectively with investors to escalate material concerns with Boards of companies. It has 50 members, both fund managers and asset owners, which have participated in over 30 successful collective engagements, the outcomes and full details of which are reported in our public annual reviews.

www.investorforum.org.uk

INTRODUCTION

Pension schemes (and, indeed, other asset owners) are increasingly focused on the powerful contribution that stewardship and engagement can make to delivering sustainable long-term returns and safeguarding value. Both growing demands from scheme members who want the value of their assets enhanced and changing regulatory demands on pension schemes[1] mean the need to identify and deploy effective stewardship capabilities has arguably never been more important.

This is why the Investor Forum and the Pensions and Lifetime Savings Association (PLSA) have partnered to develop a practical, accessible toolkit which offers schemes a framework to:

- Assess the critical components required to deliver effective stewardship
- Evaluate the quality of the approach taken by their managers and the outcomes achieved.

In working together, we aim to "connect the dots" for pension schemes and asset managers and demonstrate the value of effective stewardship and engagement to schemes and their beneficiaries.

This toolkit will help schemes identify best-in-class stewardship and engagement capabilities from their asset managers. We hope this will assist pension schemes to clarify what matters to them, and to frame their expectations of service providers.

The twin issues of sustainability and the equitable treatment of all stakeholders have never been more important. If stewardship and engagement can be effectively focused on outcomes, they become the most powerful tools that investors have to address these material issues. To offer effective stewardship, the investment chain needs to be aligned and connected – and we believe that a focus on the creation of sustainable long-term value is in the shared interest of all.

HOW TO USE THIS GUIDE

While all pension schemes and asset managers are giving much greater profile to the issue of stewardship and engagement, no two schemes are alike and no two asset managers offer identical services.

The pension scheme landscape is extremely diverse, with many different structures. A few seek to deliver engagement directly themselves, but the majority look to their appointed fund managers to carry out engagement on their behalf (and even those with some in-house capacity are likely to rely on fund manager activity for at least some portfolios, asset classes or geographies).

There will also be some difference in terms of the scope of likely influence between schemes which use segregated mandates and those which are invested in pooled funds. Although the mechanisms used for influence and challenge will vary, this guide is intended to be useful for scheme investment decision-makers in any type of arrangement and subject to different levels of intermediation.

[1] Please see *ESG and Stewardship: A practical guide for trustees* (PLSA, 2019) for a summary of these changes.

In this paper we provide:

- Definitions of stewardship and engagement, and their application across different asset classes
- An outline of how to frame an overall pension scheme stewardship strategy
- A framework for understanding and distinguishing between different forms of engagement
- An overview of what effective engagement looks like and the key factors for successful delivery
- The key questions schemes need to ask of their asset managers.

We intend that this toolkit has a broader application across asset classes, beyond the voting of equities which is usually the subject of stewardship discussion and commentary. Our language therefore focuses on engagement with assets and not just companies as is more typically discussed.

The objective is to provide a framework and, most importantly, practical insights which can contribute to an effective alignment of the investment chain to enable pension schemes, and all asset owners, to meet their long-term obligations through their asset managers.

STEWARDSHIP AND ENGAGEMENT: THE BASICS

A scheme's stewardship and engagement programme may be driven by a desire to derive sustainable benefits for society, may arise from an understanding of the benefit for long-term returns and fiduciary duty, or may simply be a response to regulatory change. Each and every such programme will have beneficiaries' interests at its core.

DEFINITIONS OF STEWARDSHIP AND ENGAGEMENT

We define stewardship and engagement as follows:

- **Stewardship** means investing pension scheme members' money in a way that preserves and enhances its value. It is a way of effecting the fiduciary obligation that pension schemes have towards their members, and that asset managers fulfil on behalf of pension schemes.
- **Engagement** is purposeful dialogue with a specific and targeted objective to achieve positive change in the interests of beneficiaries, delivering good stewardship.

We would also refer pension schemes to the 2020 Stewardship Code definition:

> "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."

We encourage schemes to sign up to the 2020 Stewardship Code or, where resource constraints mean that is not currently a viable option, to challenge any managers who have not signed up to the Code as to their reasons for not doing so. The shift towards a more outcomes-based reporting approach for manager signatories to the Code will also provide useful additional information for schemes when assessing their managers' stewardship capabilities and approach.

Stewardship and engagement are an integral part of the investment decision-making process, alongside portfolio monitoring and investment and voting decisions.[2] A chart setting out the components of both stewardship and engagement in greater detail is set out below.

[2] A more detailed discussion as to how engagement sits alongside effective use of voting rights to wield influence can be found in the PLSA's *Stewardship Guidance and Voting Guidelines 2020* (February 2020).

<table>
<tr><td></td><td colspan="2">Stewardship
Preserving and enhancing the value of assets with which one has been entrusted</td></tr>
<tr><td rowspan="3">…delivered through…</td><td colspan="2">Investment approach and decision
Allocation of capital in accordance with investment purpose, mandate and client interests, at portfolio and individual asset levels</td></tr>
<tr><td colspan="2">Dialogue
Active discussions between companies and investors, of which there are two principal forms:</td></tr>
<tr><td>Monitoring
Dialogue for investment purposes: to understand the company, its stakeholders and performance.
Informs incremental buy/sell/hold decisions</td><td>Engagement
Purposeful dialogue with a specific and targeted objective to achieve change
Individual or collective basis as appropriate</td></tr>
<tr><td>…typified by…</td><td>Detailed and specific questioning; investors seeking insights</td><td>Two-way dialogue; investors expressing opinions</td></tr>
<tr><td rowspan="2">…characteristics of high quality delivery…</td><td colspan="2">• Framed by close understanding of nature of company and drivers of its business model and long-term opportunity to prosper
• Appropriately resourced so dialogue can be delivered professionally in the context of full understanding of individual company
• Dialogue must be consistent, direct and honest
• Dialogue is respectful and seeks to build mutual trust</td></tr>
<tr><td>• Set in a context of mutual understanding of fund manager’s investment style and approach
• Recognises that change within companies is a process and sometimes takes time to be reflected in external indicators of performance
• Resources are used efficiently so that neither party’s time is wasted
• Fuller insight leads to better informed decisions
• Includes feedback so that mutual understanding can be reinforced over time</td><td>• Set in a context of long-term ownership and focus on long-term value preservation and creation, so that engagement is aligned with investment thesis
• Recognises that change is a process; while haste may at times be needed, change cannot be inappropriately rushed
• Overall resources used efficiently so engagement coverage is as broad as possible whilst also proving effective
• Clear and specific objective leads to effective change
• Involves reflection so lessons are learned and taken fully into account in future</td></tr>
<tr><td>…resulting in…</td><td>• Changed investor decision-making
• Efficient capital allocation by investors
• Appropriate risk-adjusted returns for clients
• Preserved/enhanced value
• Delivery of client objectives and investment purpose</td><td>• Changed company behaviours
• Efficient capital allocation by companies
• Appropriate risk management by companies
• Preserved/enhanced value
• Delivery of corporate purpose and culture, through effective oversight</td></tr>
</table>

BEYOND EQUITIES

Stewardship and engagement are sometimes mistakenly seen as issues that apply only in the context of equity investments. In reality the stewardship mindset should be applied across all investments held by fiduciaries, and effective engagement will maintain and enhance long-term value in any asset class.

It should also be noted that policymakers increasingly expect stewardship to be exercised by pension schemes and asset managers across the full portfolio – resource permitting.[3] However, it is also recognised that prioritisation across asset classes will likely take place as schemes progress on the full responsible investment journey at a pace which is in line with their resources and governance capability.

The following table[4] gives an indication of ways in which the concepts of engagement and stewardship might be applied across different asset classes:

	MANDATE CHOICE	INVESTMENT INTEGRATION	ENGAGEMENT
Passive/index tracking	Trustees should consider the index benchmark and any ESG tilts.	No/limited manager discretion in stock selection.	Managers can exert influence on companies through engagement and voting. There is also scope for influence on market-wide and system-wide issues.
Active equity	Trustees could invest in ESG-oriented mandates such as sustainable equity.	Managers should consider financially material ESG factors and their impact on future profitability in company evaluation. Traditionally, data availability and quality has limited the ability to do this in quantitative analysis, though this is changing.	Managers can exert influence on companies through engagement and voting.
Active fixed income	Some assets such as green bonds could be considered by trustees but likely as part of a broader mandate.	Managers should consider the potential for ESG risks to impact credit ratings and borrowers' future ability to make repayments.	It is possible for managers to have engagement with borrowers on material ESG risks, particularly at the time of initial issuance.

[3] For instance, the 2020 Stewardship Code contains explicit references to stewardship practices beyond equity holdings and the 2018 changes to the *Occupational Pension Scheme (Investment) Regulations 2005* also included disclosure of policies on engagement and not just voting, as had been the case previously.

[4] This has been adapted from *ESG and Stewardship: a practical guide to trustee duties* (PLSA, June 2019).

	MANDATE CHOICE	INVESTMENT INTEGRATION	ENGAGEMENT
Real estate	Some real estate strategies could have E and/or S objectives, and appropriate assets may be targeted to achieve these.	Managers should consider material E&S risks during acquisition and development and manage resource use during occupation.	Managers can engage with tenants and the local community to address potential issues and drive change.
Infrastructure	Trustees can consider portfolios biased towards infrastructure that supports a sustainable future.	Managers should assess the physical and societal risks arising from infrastructure assets. Longevity of investment means that systemic issues need to be considered.	Managers can exert influence on underlying companies or asset management through governance arrangements (e.g. board seats).
Private debt	Trustees could consider mandates that target lending at certain sustainable activities.	Managers should identify and seek mitigation of potential ESG risks during due diligence on loans.	Managers should have ongoing dialogue with borrowers to ensure that emerging and identified ESG risks are managed.
Private equity	Trustees can assess which companies the manager may target and the potential for unwanted or desired ESG exposures to arise.	The longevity of the investment means that systemic risks need to be considered. Managers should assess potential ESG risks during due diligence and ongoing ownership.	Managers would be expected to have a high level of influence over company management and ensure that governance structures are effective.

This toolkit is intended for broad application and thus focuses on engagement with assets and not just companies as is more typically discussed.

While some specific investor rights differ by asset class, engagement is most successful through the exercise of influence. Neither investment style, asset class, nor firm size inhibit stewardship; rather effective stewardship rests on a clear understanding of schemes' priorities on behalf of beneficiaries, and the focus of the investment process.

As the table demonstrates, when investment is in asset classes other than equities or corporate debt it is still possible to engage meaningfully with those responsible for oversight of the assets and to encourage more effective investor scrutiny and management. For this reason, this guide does not explicitly cover voting practices in depth – although effective stewardship of listed equities may require use of voting to provide either sanction or support for corporate behaviour, alongside engagement (see below 'A note on voting').

DIFFERENT APPROACHES TO ENGAGEMENT

Engagement can be split into two primary types: either **undertaken individually**, by an institution in its own capacity (which we refer to here as individual engagement), or involving some level of interaction and **collaboration with other shareholders**.

Typically, there is an escalation of the intensity of activity to reflect growing levels of concern and recognition of the need for change. Investors should be prepared to escalate where necessary where the target of their engagement is repeatedly failing to respond meaningfully to their concerns on a specific issue. A sensible escalation strategy – including appropriate trigger points and timescales – should be considered at the beginning of any engagement approach, although some flexibility and ability to adapt to a changing situation is advisable.

INDIVIDUAL ENGAGEMENT

There are a number of different approaches which investors can employ to engage directly with issuers, although we recognise that many schemes may not necessarily have the resources to do so themselves.

We outline the primary forms of individual engagement below, set out roughly in order of the intensity of the activity involved and so also in order of the likely prospect of concrete impact.

1.	Generic letter	Broad communications across a swathe of investment holdings
2.	Tailored letter	More targeted, can cover a range of topics at varied levels of detail
3.	'Housekeeping' engagement	Annual dialogue maintaining and enhancing a relationship with an asset, but with only limited objectives
4.	Active private engagement	Targeted and specific engagement
5.	Active public engagement	Engagement deliberately made public by the institution

Some of the most effective engagement takes place privately, and investors should work to develop a constructive dialogue with the individuals and organisations they are targeting to better influence and challenge. However, should insufficient progress be made over the appropriate timescale and where investors have concerns about management willingness to make the necessary changes on a material matter of concern, serious consideration should be given to how best to deliver on the stewardship objective. Alternative steps might be to sell a position, if the mandate allows, or to escalate engagement, perhaps by going public, or perhaps through collaborative engagement.

COLLABORATIVE ENGAGEMENT

Also commonly known as collective engagement. Combining an individual institutional investor's voice with those of others across the investment chain can be a powerful way of encouraging effective change at companies on issues of shared interest. We would particularly encourage those schemes with lower levels of resource or governance capability to consider how they can work with other investors, or whether joining pre-existing collaborative initiatives such as Climate Action

100+ may be effective in helping them to influence for positive change in the interests of beneficiaries.

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.

Below are the primary forms of collaborative engagement. Again, these are set out roughly in order of the intensity of the activity involved and so also in order of the likely prospect of concrete impact.

1.	Informal discussions	Institutions discuss views of particular corporate/asset situations
2.	Collaborative campaigns	Collaborative letter-writing or market/sector-wide campaigns
3.	Follow-on dialogue	Asset engagement dialogue led by one or a few investors in follow-up to a broader group letter or expression of views
4.	Soliciting support	Solicitation of broader support for formal publicly stated targets
5.	Group meeting(s)	One-off group meeting (or series of meetings) with an asset, followed up either with individual investor reflections on the discussion or with a co-signed letter
6.	Collective engagement	A formal coalition of investors with a clear objective, typically working over time and with a coordinating body
7.	Concert party	Formal agreement, in whatever form, with concrete objectives and agreed steps

CREATING THE RIGHT FRAMEWORK FOR STEWARDSHIP AND ENGAGEMENT

Appropriate topics for engagement include all issues that are relevant to performance over the time-horizon that matters for the pension scheme.

This will certainly include **financial returns**, **strategy**, **capital structure** and **operational effectiveness**. But it will often also extend to **risk management**, including the longer-term risks that have historically been poorly integrated into investment thinking, usually called **"ESG issues"** (environmental, social and governance).

Some pension schemes, with relevant mandates, will also be seeking to deliver impact through their investments, and to measure the impact that is delivered.

Stewardship and engagement are becoming crucially important disciplines as pension schemes begin to specify views on the need for the assets on which their futures depend to address concerns about sustainability and equitable treatment of stakeholders. ESG issues should not simply be considered through the lens of risk management but must encompass a range of material issues which impact the strategy of companies and asset allocation decisions. As such voting policies alone are not sufficient, effective stewardship requires a comprehensive engagement capability – either from the schemes themselves or, more commonly, the asset managers they use – to hold companies to account and effect change in beneficiaries' interests.

Regardless of who is undertaking the day-to-day stewardship and engagement, scheme investment decision-makers have not delegated *responsibility* for the stewardship of their assets and so must be prepared to work with advisers to challenge and influence their managers within the available resource parameters and constraints.

Stewardship expectations need to be consistent with the mandate. There may be a natural limit that a framework can contribute to change, as the most active engagement may not align well with certain investment styles and approaches, and not all forms of engagement will be appropriate for every fund management firm.

Discussing these limitations and debating what is appropriate between the pension scheme and fund manager should develop a greater understanding on both sides:

- Asset managers will better understand the clear needs and expectations of their clients, and
- Pension schemes will be able to effectively evaluate the approaches and capabilities of their fund managers.

We provide practical examples of the key questions for schemes to use when questioning their asset managers later. It may become apparent, for example, that some approaches and issues are appropriate only for active investment portfolios and will need to be considered or tailored differently with regard to passive funds – or vice versa.

These discussions are needed to better inform a more active market for stewardship services and in turn to drive effective stewardship overall. Regardless of the investment style or specified priorities, the ultimate goal is using stewardship to protect and enhance the value of investment portfolios for the benefit of underlying beneficiaries.

BUILDING A PENSION SCHEME STEWARDSHIP STRATEGY

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

1. Agree the scheme's investment strategy and objectives
2. Develop and agree trustee investment beliefs
3. Decide the role that stewardship and ESG integration play within the framework
4. Consider what constitutes an appropriate engagement strategy and plan
5. Formulate an approach or policy for voting decisions
6. Communicate expectations to service providers
7. Monitor and hold asset managers and others to account.

Active consideration of these issues can reduce the risk of poorly considered and reactive stewardship practices which can be counter-productive, leading to frustration for both the investors and the companies involved. Further details on steps 1-5 can be found in the PLSA's 2020 Stewardship Guidance and Voting Guidelines. Below, we provide more detail on steps 6 and 7, which are vital to ensure that a scheme's policies on stewardship, engagement and voting are put into practice.

HOW THE PENSION SCHEME PROCESS CAN DELIVER EFFECTIVE STEWARDSHIP

The UK investment chain is highly intermediated, as identified by John Kay in his 2012 report and by others since.[5] As with any other investment service, the key to ensuring meaningful stewardship and investment is for pension schemes to help link up the chain by establishing a clear understanding of their expectations for stewardship and engagement.

There are two fundamental ways in which pension schemes can do this:

1. As part of the due diligence process for appointing a fund manager, a pension scheme could seek to understand how the manager sees stewardship and engagement and what its main drivers for action are, including how consistently that philosophy is applied across asset classes and geographies.
2. As part of the ongoing monitoring of an appointed fund manager, a pension scheme could seek to test whether the manager is genuinely incorporating long-term factors and the understanding built through engagement into investment decision-making.

Effective stewardship and engagement do not simply happen. They need to be given due focus. Pension schemes can help ensure that engagement occurs and delivers value by articulating their expectations, working to encourage better activity by fund managers, and monitoring the effectiveness of delivery over time. Ultimately, a well-connected chain is likely to be much more effective in delivering engagement outcomes.

[5] Please see *The Kay Review of UK Equity Markets and Long-Term Decision-Making* (2012).

In order to deliver good outcomes for beneficiaries, pension schemes can influence the effective functioning of the chain at three key stages in the process:

- Setting expectations of asset managers
- Appointing new asset managers
- Monitoring and appraising existing asset managers

We give further details on each of these stages below.

1. Setting expectations of fund managers

Schemes must ensure wherever possible, and within the parameters of their investment approach or structure, that asset managers' stewardship and engagement approaches are fully consistent with their investment strategy, policies and objectives over the appropriate time horizon. They should clearly set out their expectations of the fund managers who will in most cases be responsible for delivering the day-to-day implementation activity.

This should include clear and explicit wording for outsourced stewardship activities in the legal documents governing the relationship between the pension scheme and the asset manager, for example in documents such as the Investment Management Agreement

The key decisions which pension schemes should focus on include:

- Identifying the most material issues, including ESG factors, that the pension scheme believes should be a focus for stewardship activity;
- Deciding the extent to which they expect such factors and the lessons learnt from engagement to be built into investment decision-making; and
- Clarifying their own expectations with regard to engagement activity and effectiveness.

2. Appointing new fund managers

The appointment process for a new asset manager offers a key opportunity for pension schemes to thoroughly assess the market for a manager whose approach to stewardship, engagement and (where relevant) voting aligns with the scheme's own. Where a pension scheme is looking to hire a new asset manager through a tender and due diligence process, the statement of expectations with regard to stewardship should form a part of the contractual relationship with the manager. The due diligence process is likely to include some assessment of whether the manager can fulfil the pension scheme's expectations in the asset classes and geographies in question.

The parties will need to agree:

- The nature and frequency of stewardship reporting – annual may be sufficient for many, though some may expect an integration of stewardship issues into quarterly reporting as well.
- Whether the pension scheme expects the asset manager to deliver any voting or other associated investor rights, or whether the pension scheme expects to retain these rights and exercise them itself.

- Expectations on the content of the reporting. This should be tailored to the portfolio in question, not generic.[6]

We outline later a series of areas of discussion and key questions that might form part of a stewardship due diligence discussion.

3. Monitoring and appraising existing fund managers

It is harder to backfill new expectations into an existing asset manager relationship. The natural first step would be to share the statement of expectations with regard to stewardship with existing managers and to seek a discussion about how this fits with the manager's existing approach to stewardship. It will be necessary to develop a clear understanding of what it may be possible for the fund manager to deliver, both in terms of substance and reporting, and over what time period.

It is not expected that an agreement with a manager might be automatically terminated solely on the basis of a disappointing approach to stewardship or failure to rise to the challenge set by the statement of expectations, but that is a possible decision that a pension scheme might take. Most often, there will be a discussion about what can be delivered by when, and the pension scheme may well find that more stewardship activity is already being delivered across its portfolio than it is currently aware of.

Pension schemes which make stewardship part of the regular monitoring discussion with their asset managers will be most influential in convincing them of the importance of the issue and the need to deliver effectively. Asserting a need for engagement as a one-off action may be much less effective.

[6] This will be particularly important in light of new duties on schemes – arising from the 2019 changes to the *Investment Regulations* – to report on their stewardship, engagement and voting behaviour in more granular detail.

THE KEY CHARACTERISTICS OF EFFECTIVE ENGAGEMENT

Later in this document we highlight the key questions that schemes should be asking their asset managers to assess how and whether they are delivering effective and impactful stewardship and engagement.

Although precise approaches will vary across investment houses, we believe that the following characteristics are common to any good engagement and pension schemes should ensure they bear the following criteria in mind during interactions with their managers on engagement.

1 – The engagement approach

- The objective(s) should be specific and targeted to enable clarity around delivery.
- The objectives should be strategic or governance-led, or linked to material strategic and/or governance issues.
- The engagement approach should be tailored to the target asset.

2 – The framework for investor collaboration

- The participants should have clear leadership with appropriate relationships, skills and knowledge.
- The scale of coalition gathered (both scale of investment and overall AUM of group) should be meaningful.
- The coalition should have a prior relationship and/or cultural awareness of the target asset.

The following chart[7] sets these characteristics of successful engagement against the different forms of both individual and collaborative engagement identified above. The darker bars provide a rough indication of how effectively the forms of engagement are likely to deliver on the characteristics (remembering always that effectiveness in engagement is determined by the quality of the activity as much as the nature of the activity. Properly targeted quality engagement of a less intensive sort can on occasions be as effective as poor quality highly intensive engagement).

Pension schemes should seek to understand how the activities of their fund managers fit within this framework, understanding where most effort is placed. This is likely to provide a clear indication of the confidence the fund manager has in engagement, and how effective it is likely to be in its efforts.

[7] This chart has been adapted from *Collective Engagement: An essential stewardship capability* (The Investor Forum, November 2019).

	CHARACTERISTICS OF ENGAGEMENT FOCUS			CHARACTERISTICS OF INVESTOR GROUPING & APPROACH		
Success Factor	**1 Clear objective**	**2 Material and strategic**	**3 Bespoke approach**	**4 Effective leadership**	**5 Scale of coalition**	**6 Depth of Relationship**
Potential impact on effectiveness (low to high)	Express concern ↔ Specify change	Narrow ESG focus ↔ Include strategy and finance	Generic approach ↔ Close cultural awareness	Informal grouping ↔ Formal coalition	Limited ownership ↔ Broad and material share ownership	Limited relationship ↔ Top level access
INDIVIDUAL INSTITUTIONAL ENGAGEMENT						
Generic letter-writing				n/a	n/a	
Tailored letter-writing				n/a	n/a	
Housekeeping engagement				n/a	n/a	
Active private engagement				n/a	n/a	
Active public engagement				n/a	n/a	
COLLABORATIVE ENGAGEMENT						
Informal discussions						
Collaborative campaigns						
Follow-on dialogue						
Soliciting support						
Group meeting(s)						
Collective engagement						
Concert party						

Fund managers seeking to be effective in their engagement will be able to demonstrate that they understand, either implicitly or explicitly, these different characteristics and how they can be applied in order to be most efficient and effective given the fund's investment style and the available resources. Inviting fund managers to frame their reporting on the effectiveness of engagement (now required by the Stewardship Code) in this way may provide useful insights.

Asset managers should be able to provide a clear rationale for their approach. Pension schemes should work with advisers to probe for evidence that the asset manager has followed a logical, clear and considered process, which could look something like the below:

- Decide the key issues for engagement and how those align with the investment approach of the fund and the individual investment thesis for the asset in question
- Determine what success will look like against each of the individual objectives identified, and consider likely timelines for delivery
- Agree how engagement will be used and which approaches taken
- Consider over time how the engagement can be made more effective, including whether escalation may be necessary, including the possible use of collaborative engagement

When combined with an understanding of the influence available, and using the different forms of engagement discussed previously, pension schemes can gain a useful indication regarding the likely effectiveness of the fund manager's approach. They should use this information to work with their advisers and shape their investment decisions and next steps.

A NOTE ON VOTING

This guide focuses primarily on engagement rather than voting. Voting can be a subset of engagement, but because it is public and easily reduced to statistics it sometimes receives a disproportionate level of attention. Voting, as with all engagement, needs to be focused on seeking the outcome that companies are run appropriately and efficiently in the interests of their long-term owners. Voting thus needs to be framed in the context of the investment approach.

Pension schemes should not fall into the trap of believing that more votes against necessarily equates to better engagement. In particular active fund managers may be more inclined towards supporting a company overseen by a given board and management that they have actively chosen to invest in, and may believe that they can be more effective through dialogue than through the binary mechanism of a vote. A single vote may be no more than a mechanism to register concern – and schemes should consider doing so where they do not have sufficient resources for extensive engagement. However, some issues require a more complex communication, and for many investors a vote against is a reflection of a failure to change minds through engagement.

Voting is an important investor right, an important signalling mechanism and the ultimate sanction. Voting should be used wisely and deserves to be reported on with intelligence and considered in the same way. For further insights on how schemes should consider, build and refine their voting approaches, please see the PLSA's Stewardship Guidance and Voting Guidelines 2020 (February 2020).

QUESTIONS TO ASK YOUR ASSET MANAGER: APPOINTMENT PROCESS

Many pension schemes will not have the resource to become experts in stewardship themselves. However, asking the right questions in relation to a fund manager's stewardship approach can help identify whether their approach is aligned with the pension scheme's expectations and effective engagement is likely to be delivered in practice. Please note that the below may not be suitable in every case – and all will need to be tailored to the circumstances of the specific mandate.

1. **Understanding how the manager sees stewardship and engagement and what its main drivers for action are. This includes how consistently that philosophy is applied across asset classes and geographies.**
    - How long-term is the fund management firm's investment mindset? Is this reflected in the portfolio exposures, turnover and approach to engagement? How do these approaches vary across different teams and portfolios?
    - How does the manager decide on the resourcing given to stewardship? How is this overall resource shared across the firm's portfolios, asset classes and geographies? What plans are there for changing the resourcing of stewardship?
    - For which portfolios and asset classes does the manager believe it most needs to improve its approach to stewardship and engagement currently? What is being done to bring those up to the standards in the wider organisation?
2. **Seeking confidence in the processes by which the manager's objectives are set and progress against them is monitored.**
    - What systems does the fund manager have in place to capture engagement objectives systematically and to measure progress against those objectives?
    - What differences do those systems reveal about the nature and effectiveness of engagement between different asset classes, portfolios or geographies?
    - If different teams within the fund management firm have investment exposure to the same company or asset, how does the firm seek to have a concerted approach to stewardship and engagement? How does it leverage different perspectives and understandings of a business from those different teams?
3. **Understanding how the manager allocates its engagement efforts between the different forms of engagement.**
    - What form of engagement takes the majority of the manager's engagement resource? Why?
    - Are different forms of engagement more relevant in different asset classes, portfolios or geographies? Explain how.
    - What is the process for agreeing to escalate an engagement? What are the range of escalation tools available?
    - How does the application of escalation vary between different asset classes, portfolios or geographies? Are these differences appropriate?

QUESTIONS TO ASK YOUR ASSET MANAGER: ONGOING MONITORING

We provide here a sample of possible questions that a pension scheme might seek to discuss with fund managers. There are more here than might be used in any particular situation, and in any case not all will be suitable and all will need to be tailored to the specific circumstances.

1. **Is the asset manager genuinely incorporating long-term factors and the understanding built through engagement into investment decision-making?**
    - How are the manager's holdings in XX and YY consistent with its approach to stewardship and long-term investment? Aren't there clear risks associated with these businesses? How have investment teams factored those risks into their decision-making?
    - The manager has had lengthy dialogue and engagement with ZZ. What impact has that had on the investment decision and the relative weighting within portfolios?
2. **Is there clear disclosure of the processes by which objectives are set and progress against them monitored?**
    - Who in the team sets engagement objectives? What is the oversight process to ensure that these objectives are robust and material, and consistently so across the organisation?
    - How is progress against objectives assessed? How does the manager gain confidence that material change has indeed been delivered?
3. **Test the quality, materiality and bespoke nature of the objectives for an appropriate sample of engagements**[8]
    - Asset AA is a significant holding and faces some key risks. Can the manager demonstrate objectives that are in place for engagement with the investment, what actions have been taken to deliver those objectives and what progress has been made in delivery?
    - The manager has sold out of asset BB over the period. Can it outline the engagement experience with its management over the last two years? What would have needed to change for the manager to be comfortable continuing to hold the asset?
4. **Seek to understand how the manager allocates its engagement efforts between the different forms of engagement.**
    - What form of engagement has had the greatest focus in the last period, and required the majority of the firm's engagement resource? Why? How has the manager measured the effectiveness of this use of resources?
    - In the last period have different forms of engagement been more relevant in different asset classes, portfolios or geographies? Explain how.

[8] To enable the pension scheme to assure itself that stewardship is being delivered effectively, it will be important for the scheme to seek to lead the discussion and choice of engagements or case studies in fund manager reporting, working with advisers as relevant. This will ensure that the asset manager's response is relevant to the scheme's own portfolio and investment objectives, as opposed to taking a more generic approach.

5. **Are headline market-wide announcements reinforced by tailored company-specific activity, and how activity is escalated over time if progress is insufficient?**

   - If the firm has made substantial public statements in the last period, how do these get translated to concrete actions on the ground? How have the dialogues with individual companies changed as a result?
   - How does the manager decide to escalate an engagement if it has not been effective initially? What is the decision-making process and how do teams decide between different forms of escalation (such as collaborative engagement or going public with concerns)?

FURTHER READING

AGM Voting Review 2019 (PLSA, 2020)

Barriers to Engagement (Investor Forum, 2018)

Collective Engagement: An Essential Stewardship Capability (Investor Forum, 2019)

Defining Stewardship and Engagement (Investor Forum, 2020)

ESG and Stewardship: A practical guide to trustee duties (PLSA, 2019)

ICGN Model Mandate (International Corporate Governance Network, 2012)

Investment Association Stewardship Survey (Investment Association, 2018)

Red Line Voting Initiative (AMNT, 2018)

Stewardship Disclosure Framework (PLSA, forthcoming)

Stewardship Guidance and Voting Guidelines 2020 (PLSA, 2020)

UK Stewardship Code 2020 (Financial Reporting Council, 2020)

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