HYMANS ROBERTSON

Responsible Investment

2019 Stewardship Survey

Welcome

We're pleased to share the results of our second triennial stewardship survey.

Our first survey was undertaken back in 2016, when interest in Responsible Investment and stewardship was just on the cusp of an exponential trajectory into mainstream practice. A lot of attention and resource has been directed at this topic since then and the knowledge and sophistication of investors has continued to grow.

We find that although there are promising signs, investment managers still need to do more to keep pace with changing demands.

We hope you find this report insightful. If you would like to discuss any of our findings further, please don't hesitate to contact us.

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Key findings

Our key findings and recommendations are:

- **Greater transparency of stewardship policies and activities remains vital** to allow investors to judge the actions of their investment managers and draw comparisons between managers. Investment managers have to continue to work to make stewardship accessible to investors.
- We believe that **the adoption of an industry 'Statement of Voting Principles'** would allow an effective basis of comparisons between managers. We note strong support for this initiative within the industry.
- **Managers need to improve disclosure on corporate engagement** to allow investors to effectively scrutinise and understand activity. Discussions can take place in private however that should not prevent managers from finding new ways to report their actions and the outcomes with their clients.
- **Managers need to be clear on the actions they will take in addressing climate risk.** Few managers have clear climate policies, leaving investors uncertain as to how they will vote on climate-related resolutions or how they are holding companies to account.
- **Carbon foot-printing is a broadly adopted tool.** Managers should ensure that carbon metrics form part of their regular reporting package and continue to explore how to improve reporting on climate-related risks.

What should asset owners do?

Whilst the focus of our research has been on the practices of asset managers, asset owners such as trustees, pension committees and IGCs can also consider the actions arising from our key findings. We recommend that asset owners do three things:

- Continue to demand greater levels of transparency from your asset managers and be prepared to challenge your managers if their disclosures are inadequate.
- Look beyond the numbers. When it comes to voting, it can be informative to look at the extent to which asset managers vote against company management, however it is more informative to understand what issues asset managers are voting against management on.
- Hold your managers to account over their voting and engagement practices. Managers should be able to explain why they have taken the actions they have on issues such as climate change and if they can't answer questions adequately, keep asking.

Background

> 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.

Financial Reporting Council

The Responsible Investment landscape has evolved significantly over recent years and continues to do so at a dynamic pace. The updated UK Stewardship Code set a significantly higher standard for asset owners and asset managers, whilst introducing separate principles for service providers. This reflects both the progress made over recent years and the changing demands of investors.

Stewardship sits at the heart of successful approaches to Responsible Investment. At this pivotal time for asset managers and asset owners, our second stewardship survey sought to better understand current practices amongst equity managers, both in how they exercise their own Responsible Investment practices for clients, and in how their own firm reflects these practices.

Our survey was undertaken in October 2019 and focused solely on equity managers. We received 47 responses, although not all managers answered all questions. All data is based on periods to 30 June 2019.

Organisational culture

We believe that the culture of an organisation is driven from the top down and is instrumental in determining how managers approach Responsible Investment. In our own assessment of investment managers, we place weight on both the extent to which leadership of an organisation engages with Responsible Investment and the manner in which this is cascaded down through the firm.

Board oversight of stewardship practices is a vital component of this and is recognised in the revised Stewardship Code, with the annual reporting requirement under the Code needing Board level sign-off.

In a clear majority of cases, such scrutiny already takes place. 70% of respondents noted that their Head of Stewardship reports directly to the Board. However, in only around half of those cases (35%) is the person with overall responsibility actually a Board member.

Another cultural issue is that of gender diversity. Over recent years, initiatives such as State Street's *Fearless Girl* campaign and the *30% Club* have promoted the need for change, with such campaigns becoming increasingly widespread. These ambitions are broadly supported by investment firms with over half of respondents (57%) having a formal policy or stated ambition to support gender diversity on corporate boards.

It is informative then to consider how well investment managers themselves reflect the broader ambitions of the sector: are managers actually practicing what they preach? The answer would seem to be no as, on average, only 20% of the Boards of investment management firms are female. This is similarly reflected in the proportion of female investment professionals which also averages 20%. Whilst gender is just one aspect of diversity, it seems to be the case that investment firms can still do better in this area.

Are investment managers practicing what they preach?

57%

of respondents state an ambition to support gender diversity on corporate boards.

Yet only

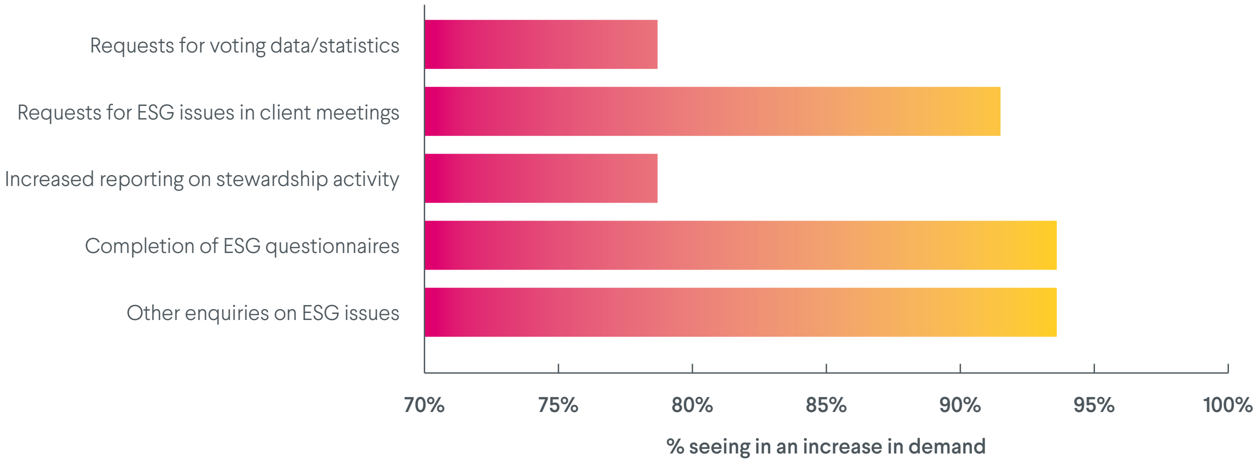
20%

of investment managers' Board members are female.

Responding to increasing demands

Given recent regulatory changes, it comes as no great surprise that investor interest in Responsible Investment issues has grown. The clear majority of investment managers noted an increase in client enquiries. Interestingly, investors have not just stepped up their interest in one area of Responsible Investment, rather they have done so across multiple areas.

Increasing investor interest in ESG issues



Investment managers cannot ignore the changing demands from their clients and must respond to this new environment. One of the ways in which investment managers can respond more effectively is by increasing the resources devoted to Responsible Investment activity. 55% of managers surveyed reported that they had done so over the last year.

Increasing resources focused on stewardship activity was also one of the themes emerging from our 2016 survey. As we discussed then, what really matters is that this development leads to the true integration of stewardship into investment decision making. Whilst addressing client enquiries is important, investors are demanding more and increasingly looking to hold their managers to account. It is essential that at least some of this resource is channelled into continuing to improve the breadth and depth of stewardship practices.

55%

of managers had increased the resource devoted to Responsible Investment activity

Resources available to investment managers also come in the form of data provision. There has been little change in the latter since our previous survey, with ISS still the primary supplier being used by investment managers. A range of ESG data providers are used by investment managers with MSCI the primary provider being used by around 80% of managers. Whilst there are often challenges raised over the consistency of ESG data, and the prevalence of a single provider may create the risk of "group think", we are encouraged that the majority of managers (63%) use more than one data provider, suggesting that multiple ESG inputs are employed in decision making. Asset owners should seek to understand how and when their investment managers use this data.

Seeking transparency for asset owners

Proxy voting remains the primary mechanism through which shareholders exercise the rights of equity ownership. Whilst larger asset owners can and do develop their own policies, many rely on the policies of their investment managers.

While asset owners are increasingly being asked to report on how their managers are exercising votes, it is vital that asset owners are able to put this information into context. Understanding the policies and processes employed by investment managers remains an important consideration for asset owners.

Transparency is a critical component of effective stewardship. We believe it appropriate that the activities of investment managers are able to be subjected to scrutiny by clients, potential clients and others. Our survey suggests that there has been no significant drop off in levels of transparency over the last three years. All respondents disclose their voting policies to some extent, with the vast majority (79%) reporting that they fully disclose policies.

79%

of managers publicly disclose their voting policies in full

While managers can be transparent, this does not mean that the information disclosed is necessarily beneficial. One issue we see in the disclosure of policies is that the ready comparison between different managers is challenging, as policy documents extend across dozens of pages and the nuance of policy goals is often unclear.

We believe that this is an area where the financial services industry can improve. In our view, the adoption of an industry standard 'Statement of Voting Principles', within which managers set out the key tenets embedded in their more detailed policy, would be of benefit. This would allow investors to make simple comparisons between managers.

We are encouraged that 77% of investment managers said that they would support such an initiative and we will be considering with industry participants how to progress this more broadly.

77%

of managers would support the adoption of an industry standard "Statement of Voting Principles"

One of the main themes that emerged from our 2016 survey was consistency in how managers cast their votes across regions. Three years ago, managers mostly customised their voting policies by region, whereas in 2019 the majority of managers (74%) were consistent in their use of a single global voting standard.

Policies can nonetheless be open to interpretation and, depending on the stance that an investor may take, it may be the case that votes could be cast differently. For instance, two-thirds of respondents noted that where shares are held in more than one fund, they will always apply a single house view. The remainder allow differentiation in voting between in-house funds. Whilst different investors can take different views on a particular issue, it is therefore incumbent on asset owners to establish exactly how a manager's voting policy will be implemented for their particular investment.

Occasionally, conflicts of interest arise in the exercise of voting decisions, with almost all managers having conflict policies in place. The vast majority also publicly disclose these policies. Conflict resolution differs between managers, with half (51%) allowing the investment team/fund manager to make the final decision on how votes may be cast. Clearly, this may depend on the reasons for a conflict: in mergers and acquisitions, the conflict is likely to be financial in nature and perhaps most readily resolved by the investment team whilst independent input may be preferable in other circumstances.

One area which has attracted significant attention among investors over recent years is climate change. Regulation requires asset owners to frame their approach to addressing climate risk and many are turning to their investment managers to understand how it is being addressed within portfolio management and stewardship activities.

Reassurance could come from managers' support for the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD) although just under half (47%) of respondents have publicly committed to support the TCFD. Even with this support, it may be expected that managers would demonstrate their commitment through making the position clearer. However, only 19% of managers have an explicit policy stating how they will vote on climate-related resolutions, with others considering resolutions on a case-by-case basis. We believe this needs to change.

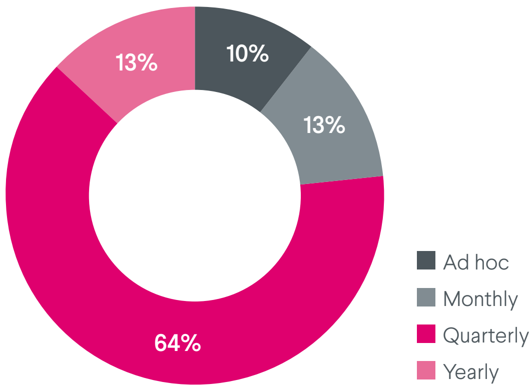
19%

of managers have an explicit policy on voting on climate related resolutions

This lack of transparency on how climate risk is being addressed in stewardship activity is a source of confusion. Asset owners want to know what their managers are doing to address climate risk and, by not clearly articulating a position, the ability of investors to hold their managers accountable is limited.

Transparency extends from clarity on policy intentions to managers reporting on their actual voting activities. From our survey, we draw a broadly positive conclusion, with the majority of managers reporting voting activity to clients, typically on a quarterly basis. This is supplemented by the fact that 78% of managers publicly disclose their voting activity, allowing some level of external scrutiny.

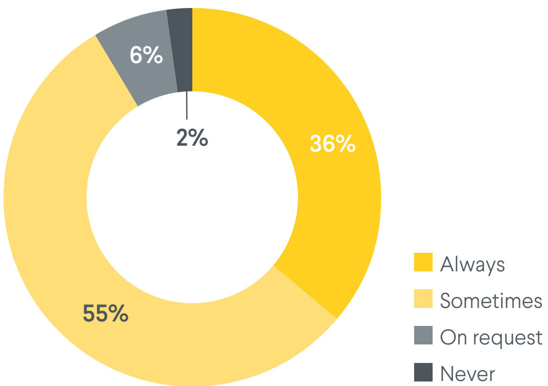
How often is voting disclosed to clients?



The extent of disclosure is generally good, with 75% of respondents reporting that they disclose detail on all resolutions, rather than just providing summary information. This allows asset owners to review voting in detail, and identify patterns and themes for further discussion with their managers.

In assessing stewardship practices, asset owners place emphasis on the extent to which investment managers do not support company management in voting at AGMs. This can often be used as a basis for judging manager activity, although context is always relevant. For example, some votes may reflect the direct application of a stated voting policy whilst others may be the outcome of a failed engagement. In allowing investors to begin to assess the effectiveness of stewardship activity, it is vital that managers provide detail on why they vote against management and, although almost all say they do, this is generally only at clients' request. Managers must always be prepared to set out their reasoning to their clients.

Do you disclose why you voted against management?



Stewardship also encompasses the ongoing dialogue between managers and investee companies, generally with the goal of identifying areas of risk and protecting, or enhancing, value. Setting clear engagement objectives is key to understanding the outcome of this activity in a meaningful way although our survey suggests this is an area for improvement.

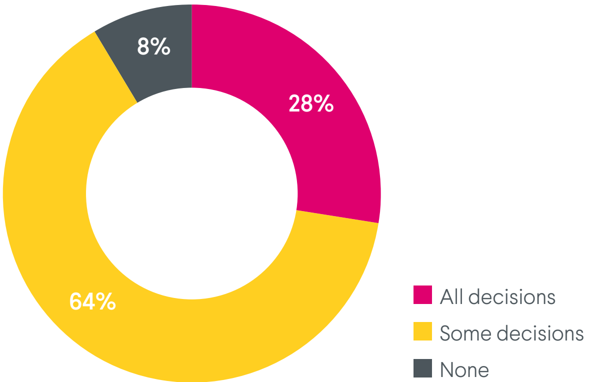
Over 75% of respondents stated that they frame explicit objectives to inform their corporate engagement activity and over 80% actively measure the effectiveness of these activities. These results compare favourably to those of our 2016 survey which showed that relatively few managers undertook explicit measurement of the effectiveness of their engagements. Further, while just over 20% of respondents disclose their activities on all engagements to clients, disclosure of engagement activity by way of a summary report (70%) or case study (66%) provides some level of information.

Therein lies one of the challenges of engagement activity. Most investment managers prefer that discussions take place in private, noting the levels of trust that are built up as a consequence. Whilst this may be true, we are beginning to see examples of managers being more open in their disclosures, naming the companies they have engaged with and the subjects they have engaged on. As asset owners demand greater transparency from their investment managers, we expect disclosures to be expanded.

Addressing climate considerations

Climate change is the issue of our time. Regulatory change and societal pressure have led to investors placing greater emphasis on how climate risks are being managed with portfolios. Many will expect their investment managers to take climate risks into account in their decision making and, encouragingly, over 90% of respondents said that they take account of climate risks in either some or all their decisions.

Explicit consideration for climate risks in stock selection



Although there may be reasons why climate risk isn't considered in all decision making, such as its direct relevance to the investment decision or the timeframe over which an investment decision is being made, we would increasingly expect climate risk to be considered as a factor.

Work undertaken by the Principles for Responsible Investment highlights the inevitability of a Policy Response if the commitments for emissions reductions made in the Paris Agreement (COP21) are to be met. Given these commitments will increasingly 'ramp up' over time, our expectation would be that managers should be taking account of the potential impact of policy shift. This seems to be the case; 64% of respondents noted that they are making allowance for the strengthening of climate policies over the next five to ten years in decision making.

One such policy initiative is likely to be the introduction of carbon pricing. Asset managers can choose to make assumptions about future carbon prices to inform decision making, however only 15% currently make direct assumptions on the price of carbon. While a potential source of concern, other approaches such as the qualitative consideration of climate and carbon emissions in decision-making remain valid, although this seems to be an area where the quantification of risk seems both possible and practical.

15%

of managers make an assumption about future carbon pricing in decision making

Asset owners are also increasingly seeking to measure exposure to climate risks, although the complexity of the subject makes this challenging. Carbon footprinting exercises have generally been employed as a starting point, determining metrics such as exposure to current and potential future carbon emissions. This in turn may be a proxy for exposure to the impact of transition risk through policy shift.

The growing availability of data means that investment managers are increasingly able to calculate these standard metrics, yet only 60% of respondents report that they calculate the carbon footprint of their portfolio as a matter of course, with around 70% of those managers reassessing their portfolio on at least a quarterly basis. For those managers who engage in such exercises, the majority then report this information to their clients.

We see the direction of travel on climate risk reporting as inexorable. Investors are being increasingly challenged to better understand climate risks and asset managers can help in this regard, both by communicating conventional metrics and considering how climate risk can be better measured. The potential for innovation is high.

Contact us

If you would like to discuss this report further, please don't hesitate to get in touch with one of our RI and Climate Change experts.

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