Summary of workshop on aligning stewardship objectives across the institutional investment community, 26 February 2020

Summary

On 26 February 2020, the FCA, the Financial Reporting Council (FRC), the Department for Work and Pensions (DWP) and The Pensions Regulator (TPR) held a joint industry workshop on investor stewardship.

Stewardship by asset owners and asset managers involves active oversight of assets in which they invest and where they choose to invest. These activities support the functioning of the UK’s financial markets by enhancing their quality and integrity, and they contribute to sustainable long-term value creation for clients and beneficiaries. In the long run, effective stewardship is expected to have wider economic, environmental and societal benefits.

The FCA’s Feedback Statement on investor stewardship (FS 19/7), concluded that the FCA should not impose further stewardship-related requirements on regulated firms now. FS 19/7 observed that new rules on shareholder engagement (implementing the revised Shareholder Rights Directive (SRD II)) had only recently been introduced. The FCA considered that the UK Stewardship Code 2020 should also be allowed to bed in before further regulation was contemplated.

However, FS 19/7 also identified a number of informational, incentive and other barriers to effective stewardship. The FCA committed to working with industry, Government and other regulators to help address some of these barriers and promote effective stewardship in line with a set of ‘key attributes’ identified in the Feedback Statement.

The focus of the workshop was therefore to explore practical steps to help address barriers to the institutional investment community’s working effectively towards common goals. In particular, the workshop explored how asset owners set and communicate their stewardship objectives, and how effectively these are adopted by asset managers and service providers. The purpose of this briefing is to summarise the discussion for delegates and other stakeholders, and to communicate the next steps that will be taken forward.

Around 40 stakeholders from across the institutional investment community attended the workshop, along with representative bodies, trade associations, non-governmental organisations, academics and other experts. The discussion was engaged, constructive and challenging. Many delegates saw considerable value in bringing all relevant constituencies together. They encouraged the regulators to hold similar events in the future.

The regulators have considered the issues and ideas raised in the workshop. We set out below the key themes from the session and some next steps. Most of the suggestions for further work can be taken forward by existing industry working groups and initiatives, with the regulators and Government remaining closely engaged.

Next steps include further work in the areas of contractual and non-contractual arrangements between asset owners and asset managers – including in relation to voting transparency and practices, and asset manager reporting – and the role of investment consultants. Progress on these next steps may be delayed by the current focus on dealing with the implications of the Covid-19 pandemic. However, there remains a strong commitment across all participants to return to these issues.

Key themes

Many delegates stressed that steps need to be taken to encourage the right level of investment in stewardship, and to build greater trust and promote deeper collaboration between asset owners and their agents. Some key areas of focus were identified to help make progress in this direction. These are summarised in this section.
Clarifying objectives through contractual and non-contractual arrangements between asset owners and asset managers

Injecting a long-term perspective in contracts

Beyond any regulatory requirements, contractual arrangements between asset owners and asset managers govern the level of service that a firm is contracted to provide. Delegates observed that contracts between asset owners and asset managers often do not explicitly set clear stewardship objectives. It was noted that some contracts also include terms that may be incompatible with a long-term investment strategy (e.g. quarterly performance evaluation). Where an asset owner values stewardship and has long-term objectives, additional provisions may be necessary.

There was appetite among some delegates to consider whether contractual arrangements could be developed with reference to a model mandate with a longer term orientation – although it was acknowledged that past such initiatives had not gained traction. An existing example suggested by some stakeholders as a useful starting point was the model mandate developed by the International Corporate Governance Network (ICGN).

Enhancing non-contractual arrangements

Many stakeholders saw a case for a deeper, collaborative dialogue between asset owners and asset managers – in which asset owners were clear about their stewardship objectives and asset managers were receptive and responsive to these objectives. The mechanisms stakeholders proposed to address this included side letters, and workshops to discuss case studies and examples of best practice.

Such mechanisms could help to set clear expectations for asset managers beyond specific contractual provisions. The Brunel Asset Management Accord was cited as an example of how to clarify what an asset owner expects of its asset managers in areas such as long-term orientation, communication and collaboration.

Increasing the transparency of the activities agents undertake to fulfil those objectives

Engagement activities

Many delegates agreed that high quality, perhaps narrative-based, reporting on engagement activities can provide clients with valuable information on how stewardship is being exercised on their behalf. However, delegates noted that such information should be representative, rather than selective. It should also be presented with reference to the client’s stewardship objectives.

Some workshop participants also considered that asset managers should articulate the outcomes they were seeking to achieve through their engagement activities – and, to the extent possible, the outcomes that they had achieved. It was observed that asset managers were already giving close consideration to how to enhance disclosures in this area in response to FCA rules implementing SRD II, and the UK Stewardship Code 2020.

Voting policies and practices

Voting is regarded as an essential component of effective stewardship of listed equity assets. There were some strong calls to ensure that, where an asset owner has communicated clear voting preferences (such as the 'red lines' voting guidelines developed by the Association of Member-nominated Trustees (AMNT)), the asset manager either adopts those directions or benchmarks its votes against those directions, explaining any deviations.

- No consensus was reached on directed voting, especially where this might lead to split votes in pooled funds. While some asset owners saw this as an important element of the exercise of their own stewardship obligations, there were equally strong legal and technical reservations. As part of this, there was some discussion of the limitations of the extant voting infrastructure. A number of delegates suggested that this was cumbersome and no longer 'fit for purpose'. Some expressed the view that voting should be considered as integral to asset managers’ overall investment approach.

- There seemed to be more agreement with the principle of enhancing voting transparency. This was regarded by many as a basis to hold asset managers to account on how well they were meeting asset owners’ preferences. However, there were differences of view on how detailed such benchmarking information needed to be. Some delegates observed that a
balance should be struck between providing decision-useful information to asset owners, while avoiding excessive tailoring of reports. This was identified as an area where further work was necessary.

**Strengthening mechanisms to hold agents to account**

**Due diligence, information flow and performance metrics**

More generally, there was broad consensus that good arrangements and information flow are needed to ensure that asset owners can effectively hold asset managers to account. In addition to reporting on engagement and voting activities (see above), clients need to be confident that the asset manager resources, organises and governs its stewardship activities appropriately. Some workshop participants suggested that gathering evidence on these matters may require asset owners to undertake due diligence visits, in addition to a regular flow of detailed, but proportionate, reporting. Among the additional data elements discussed, delegates noted the need to understand how the asset manager deals with matters such as conflicts of interest and stock lending.

Some delegates suggested that a few specific ‘minimum’ disclosure items or hygiene factors could perhaps be identified that would help asset owners monitor performance against their stated objectives on an ongoing basis. It was acknowledged that these may not all be quantitative.

An important distinction was drawn between public reporting – e.g., in accordance with the FCA’s rules implementing SRD II, and the FRC’s UK Stewardship Code 2020 – to help drive a market for effective stewardship, and more tailored mandate-specific information to help asset owners hold their agents to account for performance against specified objectives.

**Regulators’ roles**

Consistent with the conclusion of FS 19/7, it was generally accepted that new regulatory measures may not be necessary at this time. However, there was some reference to the role of regulators in overseeing existing stewardship requirements/expectations.

In particular, some delegates suggested that continued regulatory oversight of firms’ stewardship activities could make a meaningful difference in driving higher standards. The regulators present at the workshop were encouraged to consider what additional steps they could take, within the scope of the existing regulatory framework.

**The role of investment consultants**

**Investment consultants**

There was broad agreement that investment consultants can play an important role in helping asset owners specify their objectives, select asset managers that will best meet these objectives, and establish appropriate arrangements with those asset managers.

There was an emerging consensus among delegates that investment consultants ought to consider stewardship more systematically in asset management selection decisions. They should also provide more support and tailored advice to asset owners on an ongoing basis. At the same time, asset owners were encouraged to hold investment consultants to account. Some guidance for trustees on how to do this was published by AMNT and the UK Sustainable Investment and Finance Association (UKSIF) in 2018.

**Actions and next steps**

We expect that focussed efforts across the institutional investment community, with the right constituencies represented around the table, will be able to address key issues that have been identified.

In particular, we have explored next steps with the Stewardship Working Group and Stewardship Stakeholder Working Group, both of which sit under HM Treasury’s Asset Management Taskforce. The Stewardship Working Group comprises a group of asset managers, while the Stewardship Stakeholder Working Group comprises representatives from key stakeholders of the asset management industry – including asset owners, investment consultants, companies and interest groups. The regulators and relevant Government departments are observers on both groups.
These Working Groups are currently developing a joint report for Government which will include recommendations and next steps to promote more effective stewardship across the institutional investment community. We have fed the key themes and suggested actions from the workshop into these groups, for inclusion in the joint report. There has been strong support to include proposals for further dedicated work in two areas, elaborated below:

- Arrangements between asset owners and asset managers
- Investment consultants.

Recent events around the Covid-19 pandemic have inevitably interrupted the work of these groups and delayed progress towards finalising their recommendations. Understandably, the near-term priority has been to deal with the immediate human, market and corporate impact of the pandemic. However, across the groups, there remains a strong commitment to the long-term goal of addressing remaining barriers to effective stewardship.

Regulators and Government will remain closely engaged with further work on these issues. We want to ensure that the work benefits from appropriate representation and leadership from across relevant constituencies. We also want to ensure that it is both action-oriented and progressed on a timely basis.

Noting the reference to the role of regulators in overseeing existing stewardship requirements/expectations, the regulators have also considered how best to reflect delegates’ observations in their ongoing supervisory activities.

**Arrangements between asset owners and asset managers**

A joint group of asset owners and asset managers will work towards identifying definitive actions to:

- incorporate clear stewardship expectations and objectives into contractual and non-contractual arrangements between asset owners and asset managers; this will include consideration of whether a model mandate embedding stewardship-oriented provisions could be adopted as a basis for contractual arrangements, supported as appropriate by side letters and other non-contractual arrangements
- support the level of due diligence and information flow necessary for asset owners to monitor performance relative to their objectives and hold asset managers to account; the work will consider quantitative and qualitative mandate-specific disclosure items relevant for ongoing oversight of the resourcing of stewardship and monitoring the activities carried out in pursuit of asset owners’ objectives
- deliver, as part of this, transparency of the voting activities that an asset manager has undertaken on behalf of its asset owner clients, and how these align with asset owners’ expectations; where an asset owner has provided specific voting preferences, this should include consideration of a proportionate way to benchmark against that policy.

**Investment consultants**

Similarly, a cross-stakeholder group will undertake further work to:

- perform an assessment/analysis of investment consultants’ service provision in respect of investor stewardship, perhaps partnering with an academic
- identify definitive actions to agree minimum service standards, within the framework of the service provider principles of the FRC’s UK Stewardship Code 2020; these could include commitments around education on the role and value of investor stewardship, and considering the principles when supporting asset owners in manager selection, due diligence and ongoing assessment of performance.

This work could also help inform the Government response to the 2018 final report and order of the Competition and Markets Authority, further to its market investigation into the sector.

**Regulators’ actions**

- The FCA proactively engaged with a number of asset managers on stewardship in 2019 to understand better their aims and policies on matters such as voting and engagement. The
findings of this work were reflected in FS 19/7. The FCA considers that stewardship is a key role for asset managers given the typically long-term nature of their activities. Stewardship will therefore remain an important focus of the FCA’s assessment of asset management firms. As part of this, the FCA may consider evidence from firms’ disclosures under new rules on shareholder engagement and firms’ reporting under the UK Stewardship Code 2020. However, the FCA recognises that firms will rightly be prioritising operational continuity for the immediate future, given the ongoing Covid-19 situation.

- The FRC will continue to engage with prospective signatories in 2020 to communicate its expectations of reporting in relation to the UK Stewardship Code 2020 ahead of the first stewardship reports in 2021. The FRC will work with stakeholders across the institutional investment community to identify how stewardship reporting could be most useful and will consider the outputs and recommendations of any sub-groups to further encourage effective stewardship and the delivery of high quality stewardship reports.

- TPR’s objective is to move trustees beyond box-ticking disclosures to challenge managers and investment consultants to do stewardship better. Stewardship is a key part of fiduciary duty and trustee duties include the requirement to produce stewardship policies and report on activity. TPR’s investment guidance recommends that trustees adhere to the UK Stewardship Code 2020 with a view to improving long-term returns and reducing the risk of poor outcomes due to poor strategic decisions.

Noting delegates’ appetite for bringing a similar group together in the future, the regulators will consider the appropriate scope and timing of a follow-up session.