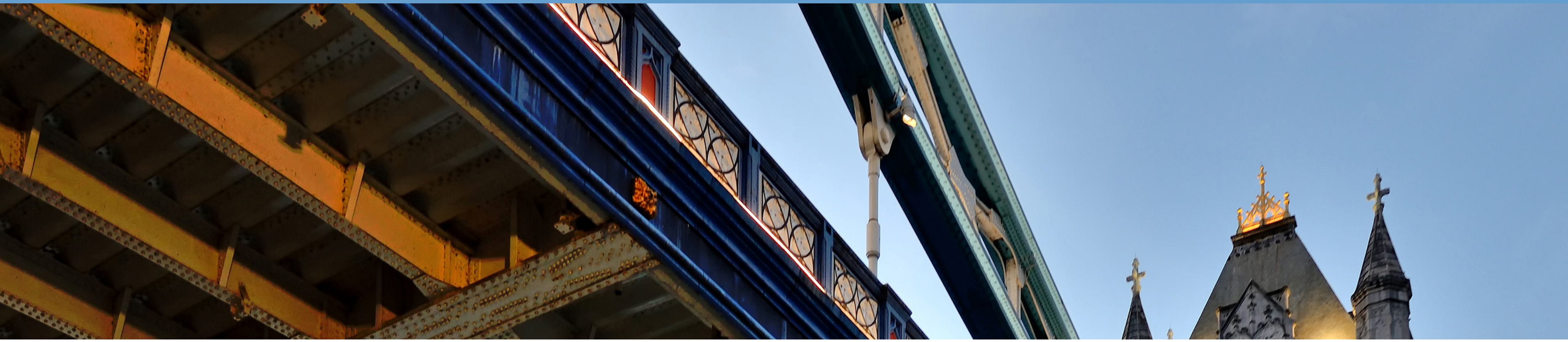


Review of Stewardship Reporting 2022

Financial Reporting Council

November 2022

Contents

Foreword

Sir Jonathan Thompson
Chief Executive Officer, Financial Reporting Council

In times of economic stress and uncertainty, investors have a vital role in helping to maintain the integrity and stable functioning of financial markets. As domestic and global uncertainty remains, investor stewardship is important for maintaining focus on the creation of long-term sustainable value for a wide range of economic and societal needs.

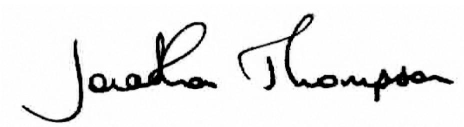
The Stewardship Code provides the framework for signatories to demonstrate how they are meeting their clients' and beneficiaries' needs, and their own commitments, through providing evidence on the activities and outcomes of their stewardship. It works in tandem with the UK Corporate Governance Code to underpin high-quality reporting and accountability in investment and governance decisions which affect us all.

This year we saw improvements in reporting in several areas, such as the quality of activity and outcome reporting for engagement, collaboration and escalation; contributions made to addressing market-wide and systemic risks; and reporting on how signatories monitor and hold to account third parties, such as asset managers and service providers. However, we still wish to see greater emphasis from signatories on reporting their activities and outcomes more effectively, using both quantitative and qualitative evidence.

We were also pleased to see increased transparency of organisational purpose and observed many examples of good reporting on stewardship in asset classes outside of listed equity, such as fixed income and real estate. We commend all applicants for their efforts in applying the Principles, letter and the spirit of the Stewardship Code. There is still some way to go on reporting outcomes, and we will continue to work with applicants to improve this.

This year was the first time we received renewal applications, and we were pleased to see that the individual feedback given by the FRC was taken on board and helped signatories to improve their reporting. It is important to understand that the Code is a commitment, and to remain a signatory, organisations must continue to apply the Code and update their reporting year-on-year to remain a signatory.

In July, we published our research, *The influence of the UK Stewardship Code 2020 on practice and reporting*. This research showed that investors have made material changes to governance and resourcing, the quality of engagement has improved under the influence of the Code, and investors are collaborating more. It also identified areas for improvement in the Code, and the Stewardship team are currently interviewing asset owners and their agents to understand how they use stewardship reporting, and their views on content, format and structure. This research will help inform our development of the Code. The government confirmed – in its response to the consultation *Restoring trust in audit and corporate governance* – that the FRC, working with the government and regulators, will review the regulatory framework for effective stewardship, including the operation of the Code, and we will continue to engage with a wide range of stakeholders to inform our approach.



Executive summary

This report provides an overview of the stewardship reporting assessed in the Spring 2022 period and explains how our expectations for reporting will evolve for the 2023 assessment year. We provide guidance for reporting on engagement and exercising rights and responsibilities, which adds to the areas we have covered in previous publications to give greater clarity and illustrate our expectations of reporting. We also give guidance on our expectations of reporting by asset owners and those investing through a third-party manager.

Part 1: Reflections on 2022 applications and expectations for 2023

On 7 September 2022, we updated the list of signatories to the UK Stewardship Code, bringing the total number of signatories to 235 organisations. In the reports assessed, we have seen effective stewardship reporting that is transparent about the purpose and approach of the organisation, and highlights progress made during the year. We noted improvements across many areas of reporting, including the following:

- The quality of activity and outcome reporting for engagement, collaboration and escalation.
- Signatories' contributions to addressing market-wide and systemic risks, and improving the functioning of financial markets.
- How signatories monitor and hold to account third parties, such as asset managers and service providers.
- Stewardship in asset classes other than listed equity, such as fixed income and real estate.

However, there still needs to be greater emphasis by signatories on reporting their activities and outcomes during the reporting period, using both quantitative and qualitative evidence.

We commend all applicants for their efforts in applying the Principles and the spirit of the Stewardship Code, and we are pleased to see that the feedback given by the FRC has been taken on board and helped signatories to improve their reporting.

In 2023, the FRC will place more emphasis in our assessment process on reporting of activities and outcomes. For Principles 4 and 7 to 12, reporting should include multiple case studies to evidence the activities undertaken in the reporting year and the outcomes of those. While we expect to see more examples from larger asset managers than we do from smaller asset owners, high-quality, informative case studies are expected of all signatories.

Asset owners highlighted the challenge of sourcing information from their asset managers and service providers to demonstrate activities and outcomes undertaken on their behalf, in time to produce their own reporting. As such, we have extended their deadline for the Spring window to 31 May 2023. The deadline will remain 30 April 2023 for asset managers and service providers.

In October 2023, we will accept only renewal applications from existing signatories, to allow us to focus on the review of the Code. This is necessary to allow the Stewardship Team to dedicate resources to effectively engage with stakeholders as we begin the planned review of the regulatory framework for stewardship alongside the FCA, DWP and TPR, and consult on the Code itself from late 2023.

A summary of the reporting deadlines for 2023 is as follows:

30 April 2023

Deadline for new and renewal applications from asset managers and service providers, and reapplications from previously unsuccessful asset manager and service provider applicants.

31 May 2023

Deadline for new and renewal applications from asset owners, and reapplications from previously unsuccessful asset owner applicants.

31 October 2023

Deadline for renewal applications from asset managers, asset owners and service providers who ordinarily submit their application to this deadline. We will not accept new applications or reapplications in this window.

Part 2: Engagement and exercising rights and responsibilities

Reports should explain how your organisation defines and practises engagement, collaboration and escalation. Application of the engagement Principles may be reported together, as long as you are clear about how you define them. The FRC considers engagement to be proactive interactions aimed at accomplishing a specific objective with an issuer or group of issuers.

A combination of metrics and narrative reporting can be useful to illustrate your engagement activities from the reporting year. Effective reporting makes use of quantitative information, which can be portrayed visually, and case studies to illustrate engagement activity from the reporting period. Reporting should be clear about what activities occurred within the reporting period, though we recognise it may be necessary to provide contextualising information from outside of it.

Reporting should reflect the way in which you are invested and include case studies of engagement across all asset classes. Indirect investors should explain the expectations you have set around engagement with your managers, and describe the activities done on your behalf in the reporting period.

Part 3: Setting expectations, monitoring and holding to account third-party managers

For those who have a mix of direct and indirect investment, your stewardship report should identify the approximate split and report across your stewardship of direct investments and those through third parties proportionately. If you invest through third-party managers, your report should explain the expectations you have set for those undertaking stewardship activities on your behalf such as integration, engagement, collaborative engagement, escalation and the exercising of rights and responsibilities. Your report should also explain how you monitor and hold to account those undertaking stewardship activities on your behalf, using illustrative case studies. The FRC expects signatories to provide evidence of this from the reporting period.

We hope that this report provides clarity on the FRC's expectations of reporting and helps signatories communicate their stewardship to clients and beneficiaries.

It is the FRC's ambition to continue to support existing and prospective signatories to meet the high standards of the Code and demonstrate their commitment to stewardship. We are pleased with the influence of the UK Stewardship Code 2020 to date and the growth of signatories so far, and look forward to increasing the number of signatories over the coming years.

Part 1 Reflections on 2022 applications and expectations for 2023

Part 1 Reflections on 2022 applications and expectations for 2023

Key messages

- We have seen improvements in reporting across several areas, such as engagement, responding to market-wide and systemic risks, and monitoring and holding to account third parties.
- In 2023, the FRC will place more emphasis in our assessment process on reporting of activities and outcomes.
- We will extend the deadline for asset owner applications in Spring 2023 to 31 May.
- We will accept only renewal applications from existing signatories in October 2023 to allow us to focus on the review of the Code.

Overview of Spring 2022 Stewardship Code applications

Forty-three additional organisations became Stewardship Code signatories when the FRC updated the list in September 2022, bringing the total number of signatories to 235, with a total of £40.7 trillion in assets under management (AUM).

The 235 signatories span a range of organisations by size of AUM, asset classes, geographies, investment style and role in the investment community. We believe this wide range of signatories speaks to the flexibility and scalability of the Code, with signatories able to explain how they apply the Principles and demonstrate their commitment to stewardship.

	Number of Signatories	Added in September 2022
Asset managers	171	33
Asset owners	46	10
Service providers	18	0
Total	**235**	**43**

In April, applications were in three categories:

- new applications
- reapplications from those who were previously unsuccessful, and
- renewal applications from organisations who became signatories following an application in 2021.

This year, we received more applications from asset managers specialising in non-listed equity asset classes. This reflects the increased demand from clients to understand the approach to stewardship taken by managers across asset classes.

Observations on reporting this year

We have seen examples of effective reporting that is transparent about the purpose and approach of the organisation, and highlights the progress made during the year.

We have also seen improvements across many areas of reporting, such as the following:

- The quality of activity and outcome reporting for engagement, collaboration and escalation.
- Signatories' contributions to addressing market-wide and systemic risks, and improving the functioning of financial markets.
- How signatories monitor and hold to account third parties, such as asset managers and service providers.
- Stewardship in asset classes other than listed equity, such as fixed income and real estate.

We are encouraged to see asset owners increasing their efforts to engage with their members and beneficiaries about their views on stewardship matters and responsible investment. Asset managers continue to innovate their communications with their clients to gather views on stewardship and integrate those views into their own practice. We encourage asset managers and owners to evaluate the effectiveness of this communication and hold their agents to account where stewardship policies are not followed.

We continue to see a range of approaches to reviewing stewardship policies, with many not seeking formal internal or external assurance. Signatories should disclose the rationale for their choice of assurance. As concerns about greenwashing continue, signatories should consider what assurance will be appropriate in future to reassure their clients and governing bodies.

There still needs to be greater emphasis by signatories on reporting their activities and outcomes during the reporting period, using both quantitative and qualitative evidence. We find some reports rely too much on context and policy disclosure, rather than evidencing their application of the Code. Across some reports, we also noted inconsistencies in the quality and depth of reporting; for example, case studies of varying quality or presented differently within the same report.

We understand there may be some exceptional circumstances where an organisation may not have a case study from the reporting year for a particular Principle, and in these cases it is appropriate to include an illustrative example from outside the reporting year. However, it should be clear when this is the case.

We encourage applicants to use the Code as a framework to tell their story and explain what stewardship activities they have undertaken in the year. Stewardship reports should do this in a balanced and understandable way, to create a report that is distinctive to their organisation and their stewardship practice.

Renewals

Renewal of signatory status is not automatic and each year signatories must submit a report that meets the requirements of the Code. For renewal applications, the FRC assessed reports to the same standard as in 2021, checking that the reports contained sufficient disclosure of activities and outcomes from the reporting year and that previous feedback had been adequately addressed.

Better quality reporting included disclosure of stewardship activity which has spanned across multiple years; for example, a significant engagement or involvement in a collaborative initiative, first mentioned in last year's report which has been updated in this year's report. These cases explained the background, the activity undertaken in the reporting year and progress towards the overall outcome or resolution (see more about how this can be reported effectively on page 27).

Conversely, we also saw examples where signatories had indicated in their reporting for 2020 that they would report updates on an ongoing engagement, or other initiatives, such as changes to their stewardship processes, but failed to do so in this year's report. We encourage signatories to include some follow-ups year-on-year and use their report as an opportunity to show progress made.

FRC feedback on applicants' submissions

Feedback provided

We were pleased to see that renewal applicants had, in general, addressed the feedback we provided in their previous outcome letter. We noticed applicants had more consistently addressed the points raised in their narrative feedback rather than the feedback table.

Organisations that were previously unsuccessful noted that the FRC feedback was instrumental in preparing their resubmission and all re-applicants have now been successful.

We've had some questions from signatories about the level of feedback we provided in outcome letters this September. First time applicants were given individual narrative feedback and a table of whether each reporting expectation had been met. For renewals, we provided individual narrative feedback, as necessary, to highlight areas that should be addressed.

As a guide, new successful and unsuccessful applications received the most feedback. In general, renewal applications where we did not have material or unique points received less feedback. Our approach balances the usefulness and clarity of the feedback we provide individually to applicants with the wider resources we provide to the market on our expectations of reporting, such as this publication.

Applications submitted for consideration in April 2022 included:

- new applications
- reapplications from those who were previously unsuccessful
- renewal applications from organisations who became signatories following an application in 2021

235 Stewardship Code signatories, including 43 added when the FRC updated the list in September 2022

171 asset managers

46 asset owners

18 service providers

representing **£40.7 trillion** assets under management

Expectations of reporting for 2023 applications

A key feature of the Code is the focus on reporting on how policies are applied and the activities and outcomes of stewardship. After two years of reporting to the Code, it is time to further encourage signatories to demonstrate that they are fulfilling their policies and reporting transparently on their activities and outcomes.

All stewardship reports must address the Principles and reporting expectations of the Code across context, activity and outcome. We do recognise that in many cases, policies described under 'context' reporting expectations may not have changed between one year and the next. Where this is the case, and reporting was previously assessed as sufficient, applicants may keep the same reporting of their policies and context, alongside updated reporting of activities and outcomes.

Activity and outcome reporting across the Code

For applications received in 2023, the FRC will place increased focus in our assessment process on reporting of activities and outcomes, particularly for Principles 4 and 7 to 12, covering integration of stewardship and investment, monitoring, engagement, collaborative engagement, escalation and exercising rights and responsibilities.

Reporting to these Principles should make it clear the approach your organisation takes, giving an overview of the scale of activities undertaken throughout the year. Responses should include examples and case studies to illustrate the activities undertaken and the outcomes of those. Reporting should contain both quantitative information to communicate the scale of activities undertaken and qualitative information to demonstrate the approach those figures represent (see more about how this can be reported effectively in Part 2).

We will expect the largest organisations, with the most resources, to include the most examples. As a guide, it is difficult for a large, global asset manager to demonstrate effective stewardship across their AUM, including asset classes and geographies, with fewer than three high-quality case studies fulfilling each engagement Principle, supported by quantitative data to provide detail on scale and breadth. However, a small asset owner, such as a Local Government Pension Scheme (LGPS) fund, may be able to demonstrate their approach effectively with one high-quality case study of their own activity, or that of their agents, per Principle. For those who invest through a third-party manager, such as asset owners or those with a fund-of-funds model, your reporting should include case studies of the activities and outcomes on these Principles undertaken on your behalf.

The application of the Code may differ depending on size, type, asset classes, business model or strategy, and these are considered in the FRC's assessment. We broadly group asset manager and asset owner applicants into the categories by sizes and types, per the following table.

Signatory Category		AUM Range
Asset manager	Large	AUM more than £250billion (bn) OR global investor managing more than £100 million from its UK subsidiary
	Medium	AUM between £50bn and £250bn
	Small	AUM less than £50bn
Asset owner	Large	AUM more than £15bn
	Medium	AUM between £5bn and £15bn
	Small	AUM less than £5bn

We also seek to be consistent in our expectations around reporting of different asset classes or different roles across the investment chain.

For guidance on how to effectively report on outcomes and case studies across the Code, see the following sections of this report and our 2021 publication Effective Stewardship Reporting.

Changes to application deadlines for 2023 applications

Asset owner application deadlines

Asset owners highlighted the challenge of sourcing examples from their asset managers and service providers to demonstrate activities and outcomes undertaken on their behalf in time to produce their own reporting. As such, we have extended their deadline for the Spring window to 31 May 2023. The deadline will remain 30 April 2023 for asset managers and service providers.

For asset owners submitting applications to the 31 October deadline, this will remain the same. Those applying to this deadline have usually received the required information from their managers and service providers earlier in the year.

October application deadline

For 2021 and 2022, there were two deadlines for organisations to submit a new application (or reapplication) to become a signatory to the Code, with renewal applications for existing signatories expected for the same reporting deadline in subsequent years.

In October 2023, we will only accept renewal applications from existing signatories, to allow us to focus on the review of the Code. This is necessary to allow the Stewardship Team to effectively engage with stakeholders as we begin the planned review of the regulatory framework for stewardship alongside the FCA, DWP and TPR and consult on the Code from late 2023.

Summary of changes to 2023 application deadlines

A summary of the reporting deadlines for 2023 is as follows:

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31 October 2023

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Part 2 Engagement and exercising rights and responsibilities

Part 2 Engagement and exercising rights and responsibilities

Key messages

- Explain how your organisation defines engagement, collaboration and escalation. These definitions should be well aligned with the Code.
- Application of the engagement Principles may be reported together, as long as you are clear about how you define them.
- Use visuals and case studies to illustrate engagement activity from the reporting period.
- Be clear about what activities occurred within the reporting period; it may be necessary to provide contextualising information from outside the reporting period.
- Include case studies of engagement across all asset classes in which your organisation is invested.
- For indirect investors: explain the expectations you have set around engagement with your managers, and describe the activities done on your behalf in the reporting period.

In this part of the report, we aim to provide clarity on several aspects of good practice engagement reporting. The first sections are aimed at those who engage with issuers and exercise their rights and responsibilities directly. The final section provides guidance to those who have delegated engagement activities and/or the exercise of rights and responsibilities.

Reporting on engagement, collaboration, escalation, and exercising rights and responsibilities within the reporting period is a key part of complying with the Code and we have observed that signatories' best reporting is often on Principles 9 to 12.

Our review from November 2021 featured a comprehensive guide of how to report well on engagement. However, there are important areas of improvement needed in engagement reporting, which are outlined further here.

Defining engagement, collaboration and escalation

The FRC considers engagement to be proactive interactions with issuers aimed at accomplishing a defined set of objectives. The Code provides several examples of methods which can be used to undertake engagement activities, including but not limited to:

Engagement activities aim to achieve a specific purpose and should be considered separate from routine, monitoring interactions with issuers. Investment managers will often have periodic check-ins with issuers of the assets they hold. These are important investment activities, but they are not considered engagement in the Code. Reporting on Principles 9 to 11 should primarily feature data and case studies from the reporting period where you have proactively interacted with an issuer to achieve specific objectives, on which you can measure progress towards the goals.

The specific activities used to engage an issuer and the point at which an interaction with an issuer becomes an engagement may vary by organisation. However, in your reporting, you should align with the Code's definition to ensure reporting is fair, balanced and understandable, and improve comparability across reports and organisations.

Robeco Institutional Asset Management B.V. (Robeco), page 11

Asset manager

In addition to describing their overall approach to active ownership through engagement, Robeco explains the categories by which they classify different types of engagement. The report explains how their general objectives for an engagement may change depending on the type.

Table 2: Types of Engagement

Engagement Type	*Purpose and Process*
Value Engagement	**Purpose:** Value engagement is a proactive approach focusing on long-term, financially material ESG opportunities and risks that can affect companies' valuation and ability to create value. The primary objective is to create value for investors by improving sustainability conduct and corporate governance.
	Process: We identify potential areas for engagement using our knowledge of trends in the sustainability and corporate governance arenas, assisted by the SI Center of Expertise and service providers. The final selection of engagement areas focuses on financial materiality and engagement impact and is made following consultation with portfolio managers, analysts, and clients. Based on our research, we set SMART objectives for all engagement cases.
Enhanced Engagement	**Purpose:** Enhanced engagement focuses on companies that severely and structurally breach minimum behavioral norms in areas such as human rights, labor, environment and anti-corruption. The primary objective of enhanced engagement is to address reported shortfalls against internationally accepted codes of conduct for corporate governance, social responsibility, the environment and transparency.
	Process: The UN Global Compact and OECD Guidelines for Multinational Enterprises outline minimal behavioral standards that serve as the basis for the enhanced engagement program. The desired outcome is the identifiable elimination and remediation of any breach, and then enhancements in management processes aimed at avoiding any repeated breach. For each enhanced engagement, we address the same overarching objectives: elimination of the breach, policy, stakeholder dialogue, risk management systems, and transparency. Remediation is a key element in all enhanced engagement cases. An enhanced engagement may finally be escalated with a company's exclusion from Robeco's or our clients' investment universe, if it does not improve its ESG behavior after the engagement has concluded. The process for enhanced engagement is a formal part of Robeco's Exclusion Policy.
SDG Engagement	**Purpose:** The objective of engagement on the Sustainable Development Goals (SDGs) is to drive a clear and measurable improvement in a company's SDG contribution over three to five years through engagement. By ensuring a company's persistent relevance is reflected by its ability to address key societal needs, this strategy creates value for both investors and society at large.
	Process: SDG engagement uses fundamental research by Robeco's SI Research team to develop a strategy that aims to improve the sustainability outcomes of companies with significant potential to positively impact one or more of the 17 SDGs. The impact process follows five engagement objectives: an impact plan, SDG mapping, target setting, stakeholder management and integrated governance. A set of individual SMART milestones are developed for each objective. For an engagement case to be closed successfully, we require a majority of milestones to be completed for at least four out of five objectives.

Nordea Asset Management (NAM), **page 41**

Asset manager

NAM provides a definition of what they consider to be engagement, describing those that have input and a general expectation of the timeline for progress. Their organisation-specific parameters for engagement provide clarifying detail, while keeping well aligned with the Code's definition.

Our engagement activities combine the perspectives of portfolio managers, financial analysts and ESG specialists to form a holistic opinion and establish coherent engagement objectives. Portfolio managers actively participate in engagement activities together with our ESG analysts. Engagements often run over several years and are carried out either by NAM alone or in collaboration with other institutional investors. During the engagement period, we conduct regular meetings with the company and track progress against predefined engagement objectives. Engagement may entail a dialogue with the companies' executive bodies, influence on board composition, cooperation with other investors on joint voting at annual general meetings, and generally keeping a strict eye on the company. The dialogue allows us to put forward our expectations on corporate behaviour and to support companies in enhancing their sustainability performance. Progress reports and outcomes of the engagement are communicated to portfolio managers and financial analysts, allowing the information to be considered in investment decisions. In cases where an engagement relates to critical issues for the specific investment case or the general investability of a company, failure to meet expectations will entail escalation of the issue through other stewardship activities, such as voting, and ultimately the consideration of quarantine or divestment.

We observed that some organisations defined engagement very broadly, so any interaction with a third party, including asset managers, investment consultants or other service providers, was reported within their Principle 9 disclosures. While these interactions are valuable aspects of stewardship, the FRC assesses any engagement with asset managers and service providers under Principles 7 and 8, where you should report on how you have monitored your service providers and held them to account. Find more on this in Part 3.

Reporting on Principles 9 to 12 should be limited to engagements conducted by you or on your behalf to influence issuers in the reporting period. Please see last year's Review for further information on reporting on engagement in non-equity asset classes.

We recognise that it may be necessary to use a range of tools to achieve desired outcomes with an issuer, and therefore reporting for Principles 9 to 12 may be presented together. When doing this, it is important that reporting clearly demonstrates the expectations for each Principle, and there are enough examples to evidence your approach across asset classes and geographies.

Principle 10 requires signatories to explain how they have collaboratively engaged during the reporting period to achieve their overall objectives. The Code defines collaborative engagement as 'collaboration with other investors to engage an issuer to achieve a specific change; or working as part of a coalition of wider stakeholders to engage on a thematic issue.' You may choose to report on engagements where you have joined with a group of investors to engage a single issuer, or where you and a group have sought to engage to influence a sector, a group of companies to make a specific change, or on market-wide initiatives seeking to influence all issuers.

The Code considers collaboration to be a key aspect of stewardship and encourages all signatories to take part in collaborative engagements within the reporting period. If your organisation has not collaboratively engaged in the reporting period, then you should explain the reasons for not doing so.

Redwheel, page 33

Asset manager

Redwheel discusses collaborative activity as a member of the Climate Action100+ initiative. Redwheel clearly explains the objectives of the engagement, their role, the activity and outcomes from the reporting period, and next steps.

Engagement with Reliance Industries through ClimateAction100+

In March 2021, the Redwheel joined ClimateAction100+ and quickly became involved in the collective engagement with India's Reliance Industries focussed on emissions disclosure, carbon footprint reduction and sustainable energy transition.

The engagement group agreed on specific objectives; these were communicated to the company. Subsequent to this, multiple meetings have been held with Reliance Industries to re-confirm the company's commitment to carbon neutrality by 2035, improve emissions disclosure and trace a manageable pathway towards gradual reduction of the carbon footprint. In one of these, the company shared its plans to restructure its Oil-to-Chemicals (O2C) business, working in cooperation with Chart Industries to develop blue and green hydrogen production at the Jamnagar refinery operated by Reliance.

Shortly afterwards, the Company announced an ambitious USD 10bn investment in renewable power generation. A new Energy Business segment was created and post investment roll-out 4 gigafactories will be launched including (1) an integrated solar module factory, (2) an energy storage battery factory, (3) an electrolyzer factory, and (4) a fuel cell factory. Reliance Industries has also committed to contribute 100GW of solar capacity towards India's 2030 renewable target of 450GW.

After five months of collaboration, a member of our Emerging and Frontier Markets team became a co-lead in the engagement. Engagement priorities were at the same time amended to focus on the following:

- Outline of short-term targets and milestones [2025/30].
- Provision of current emission data compliant with the TCFD framework.
- More communication on climate strategy, progress and capex.
- Confirmation of environmental clearance pre-FID and/or M&A in the New Energy segment.

Example continues

All group participants were encouraged to hold individual meetings with the company, to assure multiple re-iteration of the engagement objectives, and report these interactions to the group as well as seek support for our engagement from their clients and other investors.

The Emerging and Frontier Markets team held additional meetings with Reliance Industries in the fourth quarter of 2021 in which they discussed business development along with progress towards carbon emissions disclosure and reduction as per our engagement objectives. Our team learned that investment in the New Energy Business is in fact accelerating and, while acknowledging progress and giving the company credit for the transition strategy implementation, discussed with the company the benefits of SBTi certification.

Furthermore, as co-lead in the collaborative project, our team also notified Reliance Industries of the upcoming assessment vs net-zero benchmark as per the timeline published on the CA100+ website at www.climateaction100.org/news/climate-action-100-shares-net-zero-company-benchmark-update-and-timeline-for-2022/

Assessment versus the benchmark will be a key focus area going forwards.

Cohen & Steers, **page 58**

Asset manager

Cohen & Steers discusses collaborative activity from the reporting period, outlining an example of where they have worked with others in the industry to influence several issuers in a sector.

Sector: U.S. midstream energy

Asset Class: Equity

Issue Midstream energy companies at an early stage of ESG adoption were not using a standardised template for their ESG reporting, hindering investors' ability to analyse and compare.

Objective/Initiative: To convince these companies to adopt a standard template for asset managers to analyse and compare, and to highlight the benefits to all parties of such a change.

Action: We worked alongside the Energy Infrastructure Council (EIC), a non-profit trade association dedicated to advancing the interests of companies that develop and operate energy infrastructure, to provide best practices guidance and resources to companies' management teams. We chose to collaborate with EIC due to the need for wider influence and reach beyond the companies that we invest in.

Example continues

We participated in discussions with the EIC ESG Working Group to define the content of an ESG reporting template and contributed to the creation of an ESG toolkit. Cohen & Steers' midstream energy analysts and our head of ESG also presented at webinars to companies' management.

Outcome: Through this exercise, we succeeded in promoting the use of greater disclosure and more harmonised company reports on ESG performance and initiatives across the industry. A template for public reporting is now in use by a majority of our investment universe (and efforts are underway to expand the number of metrics and uptake from companies).

In this case, collaboration with EIC gave us access to new skills, relationships and channels of influence. It also provided us with a fresh perspective on a reliable approach to engagement over and above our individual company engagement.

Reporting on escalation should be distinctive and explain how it builds upon an initial engagement, where specific objectives have not yet been met and further action is needed. Organisations may have different definitions of escalation: for example, some organisations may consider collaborative engagement with other investors to influence an issuer as an escalation method following an unsuccessful individual engagement. Others may consider a direct engagement with a member of the company's board as a form of escalation, where previous engagement methods have not proved successful.

The FRC is not prescriptive in requiring a single approach for all applicants. However, with Principle 11 disclosures, you should explain the activities that you use to escalate engagement according to your organisation-specific definition. Your escalation disclosures should be illustrated with a representative variety of case studies from the reporting period. Within these case studies, it should be clear when and why an initial engagement was escalated.

Fidelity International, (Fidelity) page 64

Asset manager

Fidelity includes a case study of an engagement that evolved into an escalation. In addition to detailing the context of the engagement, and the overall objectives, they clearly state which actions were considered escalation, and they articulate why they view this as the best course of action in the situation.

Reason for Engagement: We met with Fidelidade, the Portuguese insurance company, to discuss their €300mn 10.25nc5.25 T2 new issue in July 2021. While IPTs came in below analyst expectations, the company's all-male board and executive team was also one of the overarching concerns we had and a key consideration in our decision not to participate in the bond issuance.

Example continues

Details of Engagement: In Fidelidade's bond roadshow, we had raised our concerns regarding their lack of gender diversity at the board and executive level with the CEO. Therefore, our decision not to participate was no surprise to the company. We had a constructive discussion with the Corporate Development & Strategy team, who relayed that the concerns we raised at the bond roadshow had been noted and discussed in the post-deal debrief.

The team reassured us that discussions are underway at the executive level regarding the lack of gender diversity at the board level and this is something the company plans to address. However, at present the company could not give any clear road map or timeframe as to how and when this will be achieved.

One potential sticking point in addressing the lack of diversity is their Chinese majority (85%) shareholder, Fosun. The team acknowledged that cultural differences may be at play, as in China women typically have less presence at the senior level. However, this is rapidly changing and with Caixa Geral de Depósitos owning the remaining shareholdings, we see no reason why the firm cannot address the gender diversity of its board of directors and associated governance shortcomings.

Following our discussion with the company, we agreed that we would formally escalate our concerns with a letter to the Board of Directors and CEO. They welcomed this initiative as it should assist the executive team in pushing the issue with the board. This should add impetus and weight to the need to address the matter and highlights the importance of ESG engagements within Fixed Income, in particular holding private issuers to the same standards that we apply through our voting.

Engagement metrics and narrative reporting

Your reporting on Principles 9 to 11 should illustrate clearly your engagement, collaboration and escalation activities and outcomes for the reporting period. Good practice reporting includes quantitative metrics as well as qualitative narrative reporting, or case study reporting. Your chosen metrics should provide an overall picture of all engagement activities from the reporting period. They may illustrate key themes that were prioritised or patterns that were identified. These metrics may present different categorisations, such as engagements by topic or method.

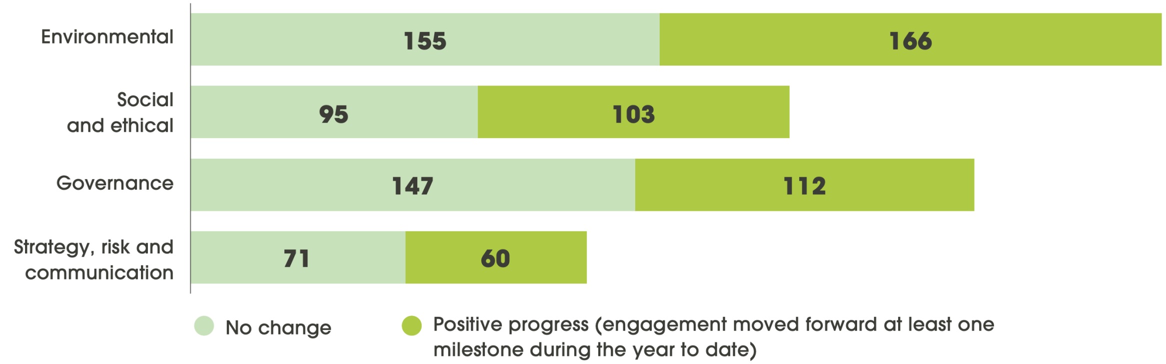
We encourage organisations to provide a good overview of their progress towards engagement objectives, and to include engagement metrics that indicate the status of engagements or milestones during the reporting period. Where your organisation has a system for tracking engagements and their progress, you should explain this in your report and define the milestones you use. Better examples of effective reporting feature visual representations of these metrics.

Environment Agency Pension Fund, pages 37 to 40

Asset owner

The Environment Agency Pension Fund provides a thorough statistical analysis of their engagement and voting activities throughout the reporting period. Graphs in this section break down engagements by progress, topic and geographies.

Progression milestones in 2021



Status of milestones in 2021 by theme

Theme	Total Engagement Objectives	Engagement objective status (last milestone completed)				Closed engagement objectives	
		Objective set	Milestone 1	Milestone 2	Milestone 3	Milestone 4	Discontinued
Environmental	321	34	47	114	73	42	11
Social and ethical	198	12	30	65	57	30	4
Governance	259	2	69	88	40	42	18
Strategy, risk and communication	131	6	32	50	25	15	3
Total engagements	**909**	**54**	**178**	**317**	**195**	**129**	**36**

Engagement globally

We engaged with 562 companies over the last year

- Environmental **23.1%**
- Social and Ethical **22.3%**
- Governance **39.6%**
- Strategy, Risk and Communication **15.1%**

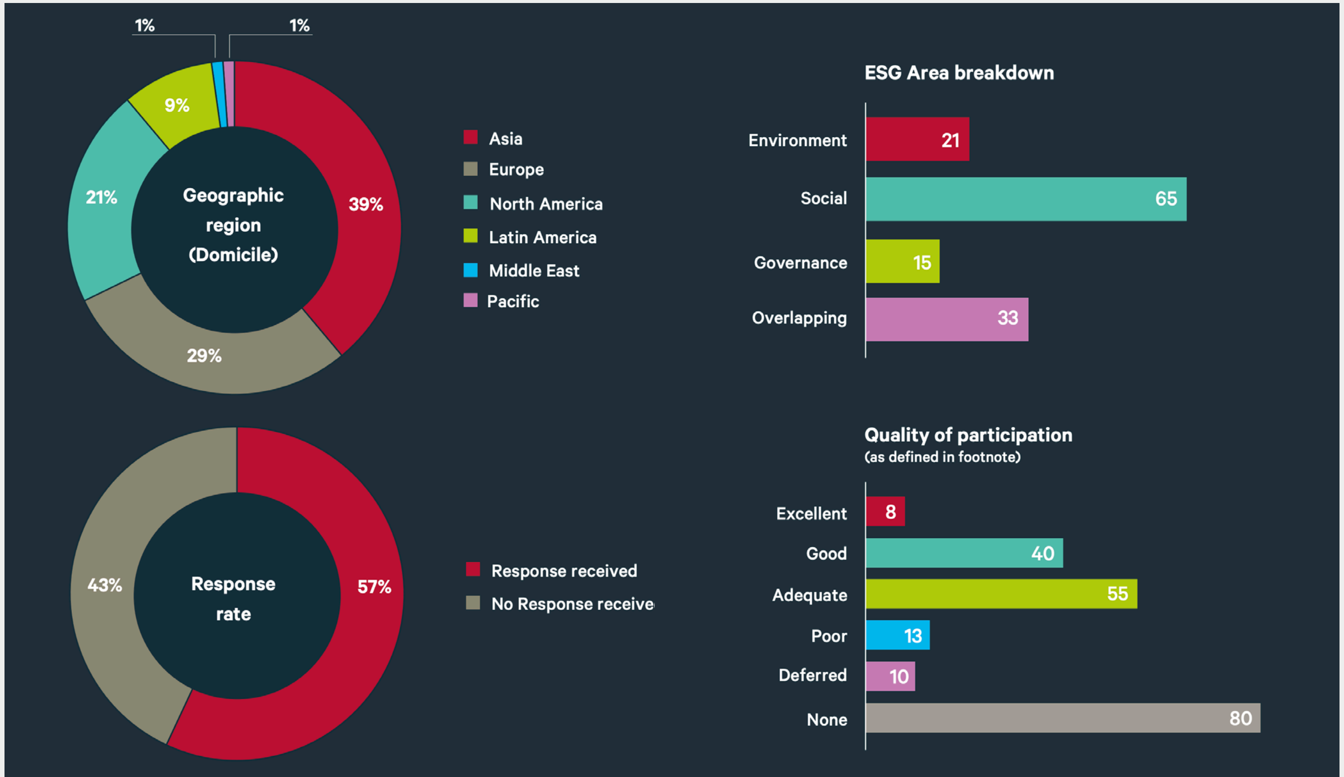
The case studies that follow metric reporting should provide more qualitative detail, identifying specific objectives, activities and outcomes. Our 2021 Review has a guide for engagement reporting that identifies key aspects of good practice case study reporting.

We have observed that where organisations provide engagement metrics, it is usually only relevant to their Principle 9 disclosures. A few organisations also provided metric reporting quantifying their collaboration and escalation activity from the reporting period. In future, we would welcome more organisations to provide metric reporting across Principles 9 to 11.

Canada Life Asset Management, page 73

Asset manager

Canada Life explain that in 2020 they joined ISS ESG Collaborative Engagement. In the graphics below, they provide an overview of their collaborative engagement activity from the reporting year through ISS, categorising their engagements by geography, topic, response, and the quality of participation.



A full list of the collective engagement activities we participated in through ISS can be found by following the link in Appendix 2.
As members of CDP, we can collaborate with other investors to put pressure on companies to disclose environmental metrics such as GHG emissions, water use and impacts on deforestation. As new members of IIGCC we started to participate in their activities and contributed our views to their consultation on developing protocols for a robust carbon offset market in 2021.

Engagement progress and reporting period-specific activity

We understand that effective engagements may take years to accomplish objectives and welcome reporting of ongoing engagements in case studies. Good practice reporting is transparent about setbacks and delays to progress. When describing an ongoing case study, you should provide sufficient information to explain the objectives, methods and actions to date. Your report should make clear what activity has occurred within the reporting period. We encourage you to provide updates to some of the case studies in subsequent stewardship reports, explaining how the engagement has evolved during the reporting period. However, it is not necessary to update on every engagement each year. The challenge of reporting on engagements in a yearly reporting cycle was identified in the independent research published by the FRC, The influence of the UK Stewardship Code 2020 on practice and reporting, where some participants responded that it is difficult to summarise progress from a 12-month period in case study reporting. We have seen many examples of effective reporting of engagements that span multiple years, and encourage signatories to report on their progress year-on-year.

Good practice reporting is transparent about setbacks and delays to progress. When describing an ongoing case study, you should provide sufficient information to explain the objectives, methods and actions to date. Your report should make clear what activity has occurred within the reporting period. We encourage you to provide updates to some of the case studies in subsequent stewardship reports, explaining how the engagement has evolved during the reporting period. However, it is not necessary to update on every engagement each year.

Federated Hermes Ltd, **page 87**

Asset managers

Federated Hermes describes a multi-year engagement with one of their holdings. In addition to linking to their previous reporting on the engagement, they provide an update on progress in the new reporting period. The case study is clear about what has occurred within and outside the reporting period.

SDG Engagement Equity Strategy – Brunswick 2021 Update

Brunswick is a global leader in recreational marine products, producing marine engines, parts and accessories, and recreational boats. In March 2018, we began our engagement with Brunswick, led by our SDG Engagement Equity strategy. This started with a positive introductory meeting with management, where it was agreed that the company needs to replicate the good work already in place at its engine business, Mercury Marine across the wider business. From 2018 through to 2021, our SDG-aligned engagements with Brunswick have focused on:

Example continues

1. Replicating Mercury's sustainability strategy across the wider group

2. Ensuring provision of decent pay and conditions

3. Developing solutions for end-of-life recycling of fiberglass vessels

4. Further 'green' product development

5. Aiming for carbon neutral production

As we described in our Stewardship Report last year, since the inception of the strategy, we have had multiple interactions with Brunswick, including a number of meetings with the company's management team, a visit to its principal manufacturing facility and considered exercising of our voting rights. We have been impressed by the human-capital management and sustainability practices of specific divisions, notably Mercury. Pleasingly, the company has extended these practices across the group and is taking a leadership position on important issues for the industry. We continue to focus on engaging constructively with management and encouraging them to keep raising their ambitions. We continue to engage on developing options for more circular usage at the end-of-life for the fiberglass material in vessels, as well as further innovations to reduce the group's direct (production) and indirect (product usage) emissions. Further to our 2020 case study, the company made the following progress in 2021/22 on our engagement objectives:

- End-of-life recycling: We have engaged with Brunswick since 2018 on the end-of-life process for aged vessels. In Q1 2022, the company announced a partnership with Arkema, a leader in speciality materials, to develop a fully recyclable fibreglass boat.

- Green products: We have encouraged the company to develop a more explicit product suite. Further to its ongoing electrification of onboard elements, such as diesel generators, in Q1 2022 the company launched an electric engine prototype. This follows the company announcing, in 2021, their intention to release new electric boat and propulsion offerings in 2022 and 2023.

Engagement and exercising rights and responsibilities across non-equity asset classes

Our 2021 review featured a section highlighting examples of stewardship activities in non-equity asset classes and how best to report your activities and outcomes in this area. We received an increased number of applications from non-equity investors during this assessment period, and were pleased to see improved and more varied reporting on engagement and exercising rights and responsibilities in this area.

Your approach to engagement may differ by asset class, geography and industry. Where your approach differs, you should explain the differences in your report. If your approach is consistent across all investments, then state this.

Waverton Investment Management, pages 42 and 47

Asset manager

Waverton explains how their engagement approach differs across asset classes in their reporting for Principle 9. They clearly state their options to exercise influence in each case and how they generally try to effect change with issuers across their AUM.

Engagement policy

We have a duty to act in the best, long-term interests of our clients and to provide responsible stewardship of their capital in a manner that creates value for them as shareholders of companies. We take investment in underlying businesses seriously and engage with management on a regular basis, believing that positive outcomes require an active approach that passive managers and/or those reliant on screening will struggle to achieve.

We are pragmatic in our approach and focus our attention on the aspects of engagement where we believe we can be most effective, with the primary objective of providing clients with genuine responsible investment outcomes that also achieve their long-term return objectives.

Direct investment approach

Direct dialogue with companies has always formed an important part of our investment process, enabling more meaningful engagement with management and ensuring a more complete understanding of their business, strategy and direction of travel. These meetings provide a forum for us to advocate for the strong governance and responsible allocation of capital that will ensure resilience in a company's underlying business model and its long-term financial sustainability.

Engagement across other asset classes

Fixed income

As fixed income investors, we do not have the ability to engage during AGMs for publicly listed companies. We are, however, meaningful capital providers to companies reliant on credit markets for their financing. Our approach to fundamental research and identifying key material issues to engage on is in line with the firm's approach as described in Principle 7. Where we see inadequacies or have queries relating to material ESG and sustainability issues, we ensure we raise these during company calls with the CEO/CFO and in writing, usually with the investor relations team, until we are reassured that the risks are managed properly.

Example continues

Multi-asset strategies

Our multi-asset team benefits from all engagement activities undertaken by the equities and fixed income teams. Additionally, where we identify an issue with management in alternatives or a real estate investment, which we feel is to the detriment of the best interests of shareholders financially or otherwise, we will engage directly with portfolio companies.

In the first instance, we will voice our concerns to both the company's broker and management. Should the issue persist, we start informal conversations with the board before formally writing to the board if the issues are not resolved. We engage with other shareholders on the issues where appropriate and often initiate conversations to voice our concerns.

With regards to collective investment vehicles, we delegate engagement and escalation. Engagement and escalation policies and records are a key part of our fund selection process, as are their ESG and sustainability approaches, where appropriate.

Where your organisation invests in non-equity assets, case studies included in your report should be proportionate to your total AUM.

The following examples demonstrate reporting of engagement case studies in several non-equity asset classes.

Fixed income: sovereign debt

Payden and Rygel, page 49

Asset manager

Payden and Rygel manages a majority fixed income portfolio, and their engagement reporting highlights several interactions with sovereign debt issuers from the reporting period.

Issuer	Nature of Engagement	Issuer Response/Outcome
Sector: Sovereign		
Ukraine	Requested 1x1 call with the Ministry of Finance. Discussed how COVID-19 pandemic may affect progress on prior actions required by the IMF focussing on items relating to governance and anti-corruption, such as land and banking reform, both of which should improve institutional strength once passed.	• The representative from the Ministry of Finance recognised the importance of prior actions, outlined the achieved progress and reiterated the authorities' commitment to IMF-sanctioned reforms. • Follow up conference calls have reaffirmed this commitment, though implementation has been spotty and new issues (such as freezing gas tariffs) have come to the forefront.
Benin	Hosted 1x1 deal roadshow with the Minster of Finance and economic team. Recognising positive points on social and environmental reforms, we questioned authorities on April 2021 elections, where there are concerns about the presidents sidelining of opposition, integrity of the election and potential consequences for the funding from key development partners.	• The minister was happy to discuss the good progress on the availability of clean water and developing human capital (healthcare, vocational training, social safety nets). However, questions around the election were largely unaddressed, as the Minister observed that the President and cabinet do not formally have a political affiliation, considering themselves a technocrat government.
Guatemala	We engaged with the issuer during the new deal roadshow roadshow to better understand the bond's structure, inquiring about the use of proceeds (how is this different than 'regular' social spending?), certification (what criteria will outside consultants use?), and reporting (how transparent will the government be?)	• Despite growing issuance of 'labeled bonds', our analysis indicates that area of social bonds is still in the early stages of development. • While noting the potential areas of improvement, we purchased the bond based on our favourable fundamental outlook, potential positive ESG impact, and attractive valuation versus secondary markets.

Real assets

Mayfair Capital Investment Management, page 59

Asset manager

Mayfair Capital specialises in direct real estate investment and their engagement report explains how they interact with property managers, tenants and the community to address concerns with their property holdings.

Engagement with a UK property manager regarding the interruption of service quality for two Mayfair Capital client mandates

During 2021, we acted on one incident where service expectations were not sufficiently satisfied by one of our external property managers. In this case, the related property manager (responsible for multiple Mayfair Capital UK mandates) was navigating a period of high staff turnover following uncertainty over their future corporate ownership. Mayfair Capital team members proactively monitored the risk relating to potential service disruption caused by staff turnover. Over time, a series of resourcing challenges did indeed arise, indicating that the property manager's services were becoming fragmented. We took action to engage with the property manager with the goal of resolving the resourcing challenges. We focused on improving the clarity of responsibilities and service expectations, as well as the re-assurance of accurate and timely reporting.

The short-term risk to service provision was resolved, however, we remain engaged with the property manager to monitor the risk of similar resourcing issues reappearing in future.

Infrastructure

BlueBay Asset Management LLP, page 43

Asset manager

BlueBay's reporting on Principle 9 includes this example of the team engaging with an infrastructure holding, outlining the objectives, methods, outcomes and next steps.

Sector level

UK water utility sector on water pollution management

Sector: Water utilities

Region: Developed markets – UK

Aim: Insight & influence into corporate practices in light of media allegations of poor river water pollution practices.

Engagement overview: We conducted engagement with some of the largest UK water and wastewater holding companies in light of emerging media allegations of river pollution resulting from illegal discharges of untreated sewage.

Example continues

The aim of these interactions was to hear the companies' response to the allegations and to better understand their water pollution management practices. Beyond this, we also used the opportunity to discuss broader ESG risks, including efforts to address issues of water scarcity and leakages, climate change and customer relations.

On their ESG management practices, the companies provided an overview of the strategies, processes and procedures they have in place to manage risks. In doing so, they provided us with a level of comfort that these are being relatively well-managed. More specifically on illegal water discharges, the companies shared the measures they have taken to protect the environment, including investments in environmental improvements, in wastewater treatment works and using natural alternatives and the latest technology to keep sewage out of rivers and take pressure off wastewater networks. Given other business activities (e.g. agriculture, mining, roads and heavy industry) potentially also contribute to pollution that harms rivers, it was apparent there was a need to ensure appropriate coordination and collaboration between different parties and stakeholders. In most cases, the companies were able to provide detailed historical performance data related to water leakages, water supply interruptions and targets for improvement.

We encouraged the companies to consider developing a more coherent sustainable finance strategy, whereby through issuing ESG labelled bonds (e.g. green bonds or sustainability-linked ones), they can attract capital to finance investments in ageing infrastructure to ensure high environmental standards.

Status & outcome: Closed – partial success. Overall, we found the dialogue with companies to be informative on our view of the sector and we were reassured about the investment exposure we currently had within the UK water utility sector across our investment-grade strategies. Since our engagement, some of the companies have come to the market with ESG-labelled issuances that help support their efforts to strengthen infrastructure and improve their environmental practices.

Multi-Asset

Fidelity International, **page 67**

Asset manager

Fidelity International describes their engagement with a listed investment company regarding infrastructure investments in US prisons. They clearly describe how the company responded to their concerns and next steps planned.

Country of Incorporation: USA

Mode of Engagement: Conference Call

Sector: Listed Investment Company

Engagement Issue: Prison Labour

Objective for Engagement: Information gathering

Asset Class: Multi Asset

We engaged with a listed investment company, active in the infrastructure sector, which has invested in some prison assets in the US. The objective of the engagement was to push for transition out of the sector or to establish an engagement plan with private and state operators, politicians, and community groups.

In our engagement, we received assurance that the fund company is not pursuing US prison investments, and that the fund's investments do not link profit with occupancy or related services such as catering. This means there is no link between the fund's return and rates of incarceration. We were also provided evidence that the fund had engaged with prison operators, including some investigations of prison management and consultation of independent impact assessments.

For next steps, we will push management for a programmatic plan of engagement with their prison operators, with measurable targets and timelines. We want to see proactive engagement with prison operators to ensure sufficient staffing, rehabilitation programs, and safety for prisoners and staff.

Indirect investors: engaging and influencing done on your behalf

Where you invest indirectly, the Code expects you to report on the engagements conducted on your behalf by your managers or service providers.

This section sets out our expectations and good practice examples of reporting. For those who invest indirectly, also see Part 3 for our expectations and good practice examples for setting expectations, monitoring and holding to account third-party managers.

Engagement

The Code expects that you report on the engagement activities and outcomes conducted on your behalf in the reporting period. Your managers should report to you their activities from the reporting period, including quantitative metrics and qualitative case studies.

Aviva Life and Pensions UK, page 56

Asset owner

Aviva Life and Pensions instructs their in-group investment manager, Aviva Investors, to manage a significant portion of their assets. In the example below, they explain a group of thematic engagements carried out on their behalf during the reporting period.

Environmental engagement for biodiversity and agricultural supply chain resilience

Protecting and enhancing the planet's precious biodiversity is an integral part of Aviva's long-standing commitment to sustainability. In 2021 we published our Biodiversity Policy to take action on tackling biodiversity loss, which complements our Aviva Sustainability Ambition and climate change focus area. We are pleased with the progress Aviva Investors has made in the following example, tackling a range of issues on this topic. Although it is great to see this selection of companies making progress, we fully support Aviva Investors' plans for further engagement and to pursue enhanced disclosure on the lagging areas identified.

Issue

Aviva Investors has taken stock of the alarming rate of biodiversity loss we have experienced in the past decades. There is increasing evidence that human activity is destroying nature worldwide, with the population sizes of mammals, birds, fish, amphibians and reptiles seeing an alarming average drop of 68% since 1970. This has been referred to as the Sixth Mass Extinction.

Agriculture has been noted to have a major role in this decline, with deforestation and land use change having been fuelled by population growth and changing consumption trends. Importantly, agriculture and other land-use changes not only contribute significantly to biodiversity loss and climate change (almost a quarter of total greenhouse gas emissions) but are also strongly affected by them, therefore posing an important risk to corporate supply chains and global food systems.

Action

In light of these concerns, Aviva Investors met with three leading names in the beverage sector – Diageo and Anheuser-Busch, in which we have equity and bond holdings, and Pernod Ricard, in which we have an equity

Example continues

holding – to discuss supply chain resilience and agricultural practices. Engagement focused on their approach to sustainable sourcing practices, namely their agricultural practices and supplier relations. More specifically, we wanted to assess supply chain resilience by evaluating progress made by these companies on key best practices such as water risk assessment and management, implementation of regenerative agriculture programmes to assist with soil resilience and carbon sequestration, the use of pesticides and fertilisers, and farmers' training, among others.

Outcome

Aviva Investors considered that these companies showed positive progress regarding their level of awareness of climate change and biodiversity in the development of new sourcing strategies, research and development investments (e.g. innovation in climate-resistant crops) as well as regenerative agriculture and farmer training programmes across different regions. Aviva Investors will continue to engage with these companies and others in the sector to monitor their progress in these and other biodiversity initiatives. Moreover, Aviva Investors also aims to pursue more disclosure on lagging areas such as water use in supply chains, reduced pesticide use and shifts to sustainable fertiliser use.

LGPS Central Limited, page 51

Asset owner

LGPS Central uses several external managers who engage on their behalf, one of which is Schroders. The case study below explains the actions that Schroders took on the fund's behalf to engage a utility company, covering the objectives, themes, outcomes and next steps.

US utility company, Schroders, LGPSC Global Equity Active Multi Manager Fund

Objective:

For company to set a clear decarbonisation strategy

ESG topics addressed:

Climate Change

Issue/reason for engagement:

The company does not have an overarching net zero commitment or quantitative targets to reduce emissions.

Scope and process/action taken:

Schroders engaged with the company in September 2021, with an expectations letter to the company's chair requesting a commitment to achieve net zero emissions by 2050 or sooner, alongside short-, medium-, and long-term targets aligned to a 1.5°C scenario.

Example continues

Escalation:

Following the initial letter, Schroders sent a tailored letter to the CEO of the utility and followed this up with a one-to-one call with Investor Relations.

Outcomes and next steps:

The company has been receptive to Schroder's requests, making valid points about the importance of having shorter term targets that the current management team can be held to, rather than long-term targets which have to be achieved by future teams. Schroders agree with this, but don't believe this prevents the company having a long-term target. In 2022 if the company fails to announce 2030 and/or 2050 targets, Schroders will re-engage.

Signatories investing indirectly have reported the engagements on their behalf in different ways: some provide direct extracts from their asset managers' reports, others summarise or re-elaborate the content of these case studies. While we do not prescribe a single approach, the case studies included in your report should still clearly explain the reasons for engagement, the methods, milestones achieved, and outcomes, including next steps. Please refer to Part 5 of Effective Stewardship Reporting for more information.

If you do not directly manage assets, but you have been directly involved in engagements in some way during the reporting period, then you should aim to explain these circumstances. Be clear about your level of involvement and whether any other investors were involved. As with direct investors, the case studies included in your report should be reflective of your overall AUM, the geography where you are invested, and the variety of outcomes your engagements experienced.

Cumbria Local Government Pension Scheme (LGPS), page 55

Asset owner

Cumbria LGPS uses external managers to manage all of their assets. A significant amount of engagement is done on their behalf by these managers. However, as they explain below, they are members of the Local Authority Pension Fund Forum (LAPFF), through which they can contribute to and influence engagements with issuers carried out in collaboration with other LGPS funds.

Cumbria LGPS is a member of LAPFF. LAPFF is a collaborative shareholder engagement group which brings together 84 local authority pension funds and 7 pools (including BCPP) from across the UK with combined assets of over £300 billion. As such the Fund is able to enhance its own influence in company engagement by collaborating with other Pension Fund investors through the Forum. LAPFF is a network organisation and a service provider, not an asset owner or asset manager, so it has no conflicts

Example continues

of interest in terms of company ownership. LAPFF seeks to protect the investments of its members by promoting the highest standards of corporate governance and corporate social responsibility (i.e. responsible action by the companies in which its members invest) on ESG issues.

Collaborative engagement

With Principle 10 disclosures, you should identify any collaborative groups or initiatives that you or your managers took part in. Provide examples from the reporting period of your third parties collaborating to accomplish their objectives and fulfil the expectations you have set for them. As with Principle 9 disclosures, these case studies should be representative of your AUM, geography of investment, and show a variety of outcomes.

Escalation

Principle 11 disclosures should include a description of the expectations you have set with your third parties around escalation. We have observed that many indirect investors give their managers a high degree of freedom in determining how to engage and escalate when necessary. If this is the case, then state this clearly. Escalation case studies should be sufficiently detailed and varied, as for engagement, and they should clearly distinguish between the engagement activity and the escalation activity.

Exercising rights and responsibilities

Where rights and responsibilities are being exercised on your behalf, the Code expects you to explain any expectations that you have set with your third parties in conducting such activities. As with the engagement reporting, you should provide specific examples of voting decisions taken by your managers in the reporting period. These case studies should be as detailed as possible, explaining the context for the resolution, the rationale for voting in a particular way, the outcome of the vote, and any next steps required for follow-up.

Principle 12 disclosures also extend to non-equity asset classes. Where your managers have invested your funds across several asset classes, your report should explain the expectations you have set for your managers in exercising rights and responsibilities across all non-equity asset classes. You should also include case studies of your managers doing so in the reporting period.

Part 3 Setting expectations, monitoring and holding to account third-party managers

Part 3 Setting expectations, monitoring and holding to account third-party managers

Key messages

- Disclose your assets under management that are invested directly and indirectly through third parties.
- Explain the expectations you have set for those undertaking stewardship activities on your behalf, such as integration, engagement, collaborative engagement, escalation and the exercising of rights and responsibilities.
- Explain how you monitor and hold to account those undertaking stewardship activities on your behalf based on the expectations you have set.
- Evidence how you have set expectations, monitored and held to account your agents in the reporting period.

The Code requires those organisations investing indirectly to explain the expectations they have set for those investing on their behalf (in Principles 7 and 9 to 12) and how they monitor and hold to account their asset managers and service providers (in Principle 8).

Investing indirectly means using third parties to undertake investment activities rather than investing directly through in-house capabilities. Indirect investing can be undertaken by both asset managers and asset owners. Examples of indirect investors include but are not limited to the following:

- A wealth manager investing through one or more third-party asset managers.
- A fund of funds (FOF) manager.
- An LGPS fund investing through their pension pool partner and other external asset managers.
- A corporate pension scheme investing through external asset managers.

In reports reviewed this year, signatories who are indirect investors explained well how they monitor and hold to account those undertaking stewardship on their behalf during 2021. However, indirect investors should better describe how monitoring is based on expectations set around key stewardship activities rather than general monitoring.

AUM and investment approach

Under Principle 6, you should disclose your AUM across asset classes, including what is invested directly versus indirectly. This gives useful context to readers, including clients, beneficiaries and the FRC, to understand how representative your stewardship activity is of your AUM and to determine if reporting is fair and balanced. If you invest directly and indirectly, under Principles 7 and 9 to 12, you should include case studies from both investment approaches. Often it was not explicit in investors' reports that they invested through third parties at all. More information on AUM reporting can be found in Part 3 of the Effective Stewardship Reporting review from 2021.

Tenders and mandates

Principle 7 requires indirect investors to explain how tenders and mandates have included a requirement to integrate stewardship and investment, including material ESG issues.

Most indirect investors provided some information on their tendering process, although the detail and quality of reporting varied significantly. Some provided a brief overview of their tendering process, while better reporting provided a more detailed disclosure of their selection process, linking it to stewardship. Indirect investors should explain the criteria or methodology on which potential external managers are assessed in your tender or due diligence process.

St. James's Place, pages 59 to 62

Asset manager

St. James's Place explains how they delegate day-to-day investment decisions to external fund managers, and describe the use of a six-stage selection process from initial design to onboarding to ensure they recruit fund managers that align with their beliefs.

Most indirect investors did not articulate how their mandates clearly set out their expectations of their asset managers in relation to stewardship under Principle 7 – this is an area which requires improvement. Better reporting explains how the mandate covers the material ESG issues you expect to be prioritised in integration, engagement, collaborative engagement, escalation and the exercising of rights and responsibilities by the asset manager on your behalf.

Railpen, page 41

Asset owner

Railpen explains how the external manager selection and appointment process works, including the factors they consider in the tendering process. They provide a reporting period case study which contextualises how the final mandate awarded includes a requirement to integrate ESG and stewardship.

External manager selection and appointment

Where new external managers are selected and appointed, we consider their ESG and stewardship policies, resources, integration into the overarching investment process, and the observable outcomes. We require the inclusion of ESG data in their investment analysis and their client reporting. We expect managers to align with our exclusion lists. We set out our expectations in our Investment Management Agreements (IMAs) via our Statement of Investment Principles that we append to all IMAs. Where necessary, we have worked with managers to enhance their integration of material ESG issues into the investment process and improve their client reporting.

In 2021, we onboarded a new external manager for a regional equities mandate. Case study 13 demonstrates how we incorporated our expectations on ESG integration, reputational factors, stewardship and climate change into the IMA. We also, in line with our commitment to the proactive and thoughtful use of voting rights, agreed that we would maintain control over our voting rights across the mandate.

Case study 13: Regional Equities Mandate | Negotiating the Investment Management Agreement

Issue

In 2021, Railpen selected an external manager for a regional equities mandate. Equities in this region typically have lower ESG disclosure and can face higher ESG risks. In the 2020 Stewardship Report how we worked to ensure ESG and stewardship was a key focus of the due diligence process. Once a manager was selected, we wanted to ensure that the legal documentation fully supported us to hold the manager to account on ESG, stewardship and climate issues in the context of our overall approach to sustainable ownership.

Approach

The Railpen Sustainable Ownership and Public Markets teams worked closely together to assess the mandate in the context of our proactive approach to stewardship, our Net Zero Plan and both current and forthcoming disclosure requirements on sustainable investment.

Example continues

We decided that it was vital the Investment Management Agreement (IMA) itself ensured:

- We can effectively exercise key stewardship tools with portfolio companies.
- We receive timely information that supports our own reporting obligations.
- That potential reputational risks are minimised as far as possible.

We also considered the use of side letters to the IMA and we will make use of them in the future to allow the contract to evolve in keeping with market developments. However, we thought it important that we clarify our expectations in what is ultimately the most important item of legal documentation governing the asset owner-manager relationship.

To this end, we undertook a series of discussions, supported by our external legal advisers, with the manager and its legal team.

Outcome

We were pleased that the ultimate IMA achieved an appropriate balance between what is reasonable for the manager to provide and our sustainable investment preferences and requirements. This included:

- Railpen maintaining full voting rights, with the manager committing to report any material engagement outcomes in time for forthcoming votes.
- Prompt reporting on any ESG or ethical incidents affecting portfolio companies.
- Quarterly reporting on material ESG issues, reputational data and engagement (including public policy) activity with issuers.
- A commitment to aligning the portfolio to Railpen's Net Zero goals within 90 days of the commencement of the IMA.
- At least annual reporting on any stewardship conflicts of interest.
- Alignment with our exclusions policy and exclusions lists.

Furthermore, the tone and outcome of discussions with the manager on these issues further confirmed our comfort with the approach and attitude of its portfolio managers and stewardship practitioners.

Monitoring and holding to account third-party managers

Indirect investors generally explained well how they monitor and hold to account those investing on their behalf (Principle 8). For example, most explained the process they use to monitor external managers, including the review process, the use of meetings and the frequency of these meetings.

Better reporting cross-references expectations set during the tendering process and mandate setting (Principle 7), and the expectations set for stewardship activities such as engagement, collaborative engagement, escalation and exercising rights and responsibilities. Better reporting also linked how asset owners are monitoring and holding their managers to account with the expectations set.

Universities Superannuation Scheme (USS), pages 39 and 49

Asset owner

USS explains how they hold their asset managers to account on page 49. Page 39 gives two case studies which demonstrate how their asset managers have met their expectations in private equity and private credit.

Setting clear expectations for managers

For our investment managers, we define our expectations of stewardship in mandates. As noted in Principle 8, we monitor their stewardship performance as a standard part of our monitoring processes. We challenge them if we feel that they are not delivering on the stewardship commitments they have made to us (e.g. the issues they are active on, the resources they are devoting to stewardship or the intensity of their stewardship efforts). If we are concerned about an investment manager's performance, and if the investment manager has not improved following feedback from us, we have a range of options.

These can include:

- Notifying the external manager about their placement on a watch list.
- Engaging the external manager's board or investment committee.

Example continues

- Reducing our exposure to the external manager until any non-conformances have been rectified.
- Terminating the contract with the external manager (or not reappointing them) if failings persist over a period of time.

Capacity building at external managers

2021 witnessed the strengthening of ESG teams at several managers where USS had been calling for better resourcing or strategy-focused support in RI following a monitoring review. Specifically:

- We welcomed the creation of new RI-Lead roles at two of the Scheme's long-standing managers where we had previously raised concerns regarding capacity and the pace of implementation of RI policies.
- We also welcomed the establishment of asset-class ESG leads at one of the Scheme's large US multi-asset managers where we felt the top-down approach to ESG lacked sensitivity to the firm's varied private markets investment strategies.
- We have also witnessed several leading RI teams grow throughout 2021 in response to the increased availability and integration of ESG data, client interest and the implementation of Net Zero strategies.

Whilst we recognise the appointments and policy updates reflect a growing interest in ESG from clients and regulators, and manager-led product developments, we believe that our engagements and discussions have played a role in catalysing such developments.

Case study: Private equity engagement – LPACs and ESG

Following the Scheme's Net Zero announcement in May 2021, our Head of Private Equity challenged the lack of discussion on climate change risk or transition at the Limited Partner Advisory Committee (LPAC) meetings for one of the Scheme's US energy funds. The comment was raised with the Head of ESG at the external manager, triggering a call from the Fund's Lead Partner and assurances around work in progress and transition of the manager's energy strategy. During the course of 2022, we will track progress and continue to engage on climate change and emissions management with the manager.

Case study: Aligning manager remuneration

We discussed the potential inclusion of RI objectives into the remuneration arrangements for portfolio managers with one of our public credit managers during a monitoring meeting in 2020. We typically raise this with managers (in both public and private markets) to improve accountability, drive alignment and RI strategy implementation. Several months after the meeting, we were pleased to be advised that all front office teams would have a specific RI goal within their performance measures for the forthcoming year.

LGPS Central Limited, page 34

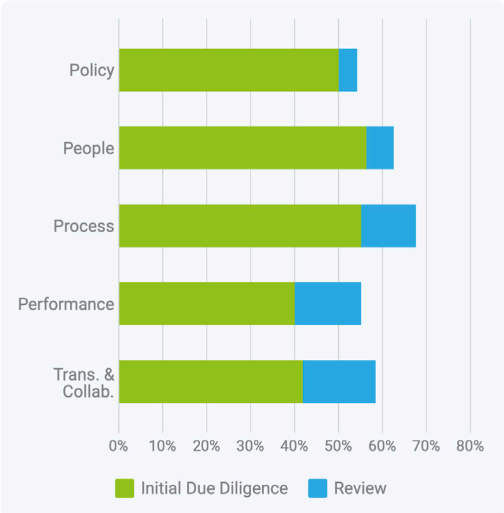
Asset owner

LGPS Central Limited explains how they monitor their private equity managers and how those managers met their expectations in a case study.

Private Markets

Private equity fund managers are monitored through regular RI&E reviews every 2–3 years. In 2021, all of our private equity funds took steps to improve their RI&E processes, reflected in improved ratings against our five-pillar scoring framework. Figure 3.3.1.1 provides a summary of the areas where our private equity managers made improvements in 2021.

Figure 3.3.1.1 RI&E improvements between the initial due diligence and review



In Q1 2021 we reached out to one of our GPs to establish RI&E KPIs for a co-investment firm. The GP provided an overview of its current monitoring efforts, which included an ESG dashboard and impact KPIs. LGPSC found the monitoring and KPI programme to be highly comprehensive and detailed, exceeding our expectations. Through its due diligence and KPI monitoring, the GP identified several areas that the co-investment could improve. As a result, the GP engaged with the firm to create an action plan, which included a 5-year ESG journey strategy and an environmental impact assessment. The GP was very transparent, sharing metrics and underlying data and welcomed LGPSC's input on KPI development. Moving forward, LGPSC will receive updated disclosure against the dashboard and KPIs on an annual basis, allowing us to track the progress of the Firm. In addition, we will continue to meet with the GP on an annual basis to discuss any areas we believe require enhancements in the future.

Expectation setting across Principles 9 to 12

Indirect investors should explain more clearly the expectations they are setting those undertaking stewardship activities on their behalf, such as engagement (Principle 9), collaborative engagement (Principle 10), escalation (Principle 11) and the exercising of rights and responsibilities (Principle 12).

Most indirect investors explained their general expectations for Principles 9 to 12. For example, asset owners stated they expect their asset managers to engage with investee companies. However, better reporting explains if they delegate the prioritisation of issues or if they direct their managers on specific topics or methods of engagement. For example, you could articulate your expectations on the use of specific mechanisms or procedures, such as filing or supporting shareholder resolutions on priority issues and voting against management to influence investee companies. You could also explain your expectations on the timeframes for the successful use of engagement, collaborative engagement or escalation. Where some element of collaborative engagement (Principle 10) is delegated to an external manager, better reporting may identify key groups or initiatives you expect the external manager to be involved in.

Indirect investors should explain their expectations of their managers undertaking stewardship activities across asset classes. You should make clear how your expectations for the stewardship undertaken on your behalf differ across asset classes, for example, depending on the rights and level of influence available.

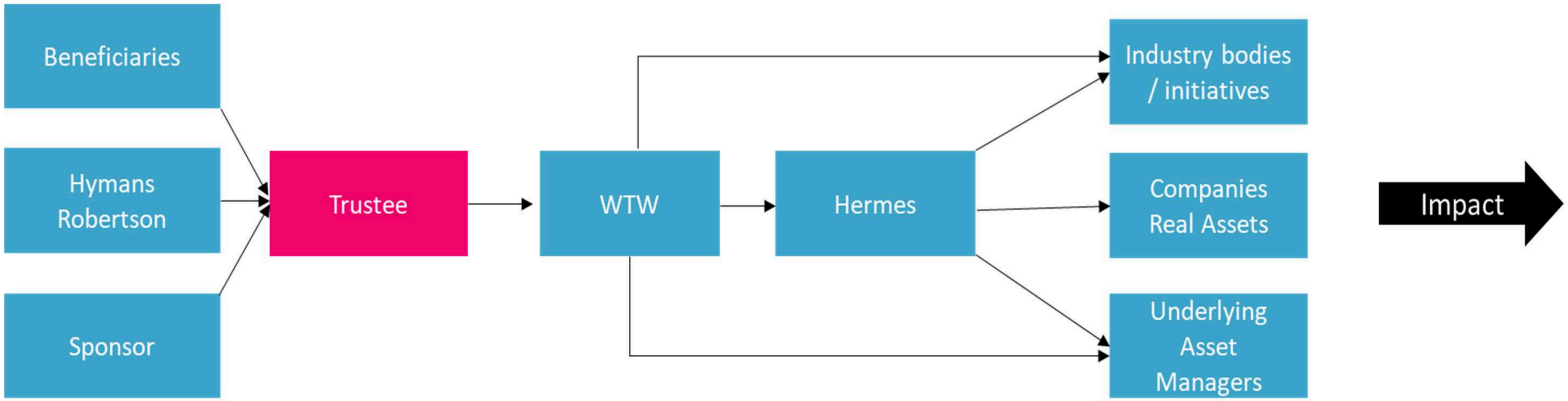
For Principe 12, most indirect investors explained their expectations for voting in listed equity assets, and there was some good reporting on fixed income. However, we expect to see improved disclosure of how rights and responsibilities are exercised in other asset classes, such as private equity, real estate and infrastructure.

In 2021, the Taskforce on Pension Scheme Voting Implementation recommended asset managers offer pooled fund investors the opportunity to set an 'expression of wish' so that pension schemes can indicate how they would like their shares to be voted on a particular issue. Linked to reporting on Principle 12, indirect investors should disclose their voting policy, including any house policies and the extent to which voting decisions are executed by another entity, and how you have monitored any voting decisions on your behalf.

Jaguar Land Rover Pension Trustees Limited, page 20

Asset owner

Jaguar Land Rover Pension Trustees employ both an advisor and a fiduciary manager. Their report explains how they set expectations for all relevant parties on how engagements should be conducted on their behalf.



As set out in the diagram, we engage with WTW, who in turn engage with underlying managers and conduct system-level engagement with the wider investment industry. The underlying managers are responsible for exercising voting rights and engaging at a corporate level. EOS conduct further corporate engagement for a proportion of the Schemes' assets. EOS also take part in public policy engagement.

As noted in our responses to principles 1 and 5, we set beliefs and undertook a process to agree the thematic areas that we wanted to prioritise, using the UN SDGs as a guiding framework. We fed this back to both Hymans Robertson and WTW and used these priority areas to develop an RI policy, with input from both Hymans Robertson and WTW.

This process took place over a series of RIWG meetings, at which WTW were present. This process made it clear to WTW (and as stated in our RI policy), that we expect them to promote active dialogue by investment managers with underlying investee entities, regardless of asset class. In particular, we expect engagement on climate and other environmental issues to be emphasised. We expect WTW to encourage underlying investment managers and EOS, to promote underlying investee entities' climate disclosures to be aligned with best practice, e.g. Task Force on Climate-Related Financial Disclosures ("TCFD"), as we believe that this will drive improved standards and transparency. This has been shared with EOS.

We cover manager and corporate engagement below with industry level engagement being covered under principle 10.

Monitoring and holding to account other types of service provider

Signatories should also explain how they are monitoring and holding to account other key service providers undertaking stewardship-related activities, such as proxy advisors, ESG data/research providers and investment consultants.

While you may use a similar approach for all your stewardship service providers, it's likely the process will be different based on the service the third party is providing. For example, a manager monitoring an ESG data provider might review the quality, accuracy and reliability of the data provided, while an asset manager monitoring a proxy adviser might review their voting recommendations and voting research quality. Better reporting would explain these key differences in monitoring and holding to account various stewardship service providers rather than providing a general process.

Allspring Global Investments (AGI), page 48

Asset manager

AGI explains how they monitor their service provider and explain the actions they have taken to hold to account their environmental data provider after their expectations had not been met.

Engaging with third-party environmental data provider

Description: In 2021, we noticed that this provider had adjusted the granularity of its industry groupings, and that this caused some industry estimates in our model to adjust unexpectedly. As a result, we engaged with the vendor to better understand the underlying changes and provide a credible challenge to their methodology. After discussion, it was established there was no issue with the accuracy of the data itself, but that the communication of the changes to end users could be improved.

Outcome: As a result, the provider has committed to upgrading their communication practices going forward, which should benefit all of their data clients.

Reporting should explain how your expectations have been met, including examples demonstrating how external asset managers and service providers have fulfilled your needs, rather than simply stating that they have done so. This can be done through direct disclosure on Principle 8 or reflecting on your asset managers/service providers' activities across Principles 7 and 9 to 12.

Where your expectations have not been met, you should explain the actions you have taken to hold to account your service providers. This could include a range of actions, from retaining the service provider after a thorough monitoring process, changing the service provider, or setting new expectations. If all your asset managers and service providers have met your expectations during the reporting year, please state that this is the case.

Aviva Life & Pensions UK Ltd, page 52

Asset owner

Aviva Life & Pensions explains the actions they have taken to hold their asset manager to account in an instance where their expectations have not been met.

Further reading

The PRI website has a range of publicly available resources, including how asset owners can select, appoint and monitoring their asset managers:

https://www.unpri.org/investment-tools/asset-owner-resources.

Further reading

The International Corporate Governance Network (ICGN) and Global Investors for Sustainable Development Alliance (GISD) Model Mandate provides guidance to asset owners to ensure their investment strategy and fiduciary obligations are properly reflected in the IMA terms with asset managers, and that they can monitor whether their objectives and interests are being met:

https://www.icgn.org/sites/default/files/2022-06/ICGN%20GISD%20Model%20Mandate%202022.pdf

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