Stewardship Disclosure Framework Consultation

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Stewardship Disclosure Framework – a consultation exercise

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

Effective engagement with companies on issues ranging from strategy and performance to risk and corporate governance can a) protect funds against reputational risk and b) play a key role in controlling investment risk; helping guard the fund against potential destruction in shareholder value.

The NAPF's Stewardship Policy set out three simple actions which can be expected of pension funds as the owners and providers of capital. These included incorporating stewardship criteria into manager searches and subsequently monitoring their activities in order to gain a greater understanding of their stewardship approach and ensuring they are aligned to and adhering to the funds' own policy.

For some time we have felt that pension funds would benefit from a tool which would assist them in assessing the effectiveness of their investment managers' approach to stewardship and to be able to identify those managers who take this agenda seriously. Such a tool would empower trustees, enabling them to 'at a glance' understand the stewardship policies and approaches of different asset managers and choose one which fulfils their expectations and help foster a market for stewardship.

We warmly welcomed the 2020 Stewardship report published last year by the Investor Stewardship Working Party. Recommendation three of this report identified a lack of quality information about the stewardship approaches of different asset managers and developed a 'Stewardship Framework' against which institutional investors can categorise themselves. We have, with the support of the 2020 Stewardship Working Party, taken forward this idea and with the assistance of a number of pension funds and asset managers have revised the Framework.

We are now issuing this revised Asset Manager Stewardship Disclosure Framework for broader public consultation and would welcome your responses to the below questions by **5 July 2013.**

Please direct all responses to Will Pomroy, Policy lead: corporate governance, NAPF at will.pomroy@napf.co.uk / Cheapside House, 138 Cheapside, NAPF, London, EC2V 6AE.

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Consultation questions

Objective

This Framework is envisaged as complementing the Stewardship Code Statements Asset Managers already make to the FRC in relation to signing up to the Code. The objective is to provide pension fund trustees, and other relevant stakeholders, an at a glance understanding of different asset managers' stewardship policies and activities. It would be expected that this would assist pension funds in clarifying their own expectations for their appointed asset manager and would provide the basis and reference point for a more constructive and detailed dialogue between client and agent.

1. Do you agree that the proposed Framework will successfully provide a useful at a glance understanding of an asset manager's stewardship policies and activities?

Yes. We strongly welcome this initiative by NAPF which we believe fills an important gap in the stewardship landscape. In the same way that the 'comply or explain' mechanism of the Corporate Governance Code relies on shareholders to scrutinise the practices of companies, the Stewardship Code's 'comply or explain' mechanism relies on asset owners to scrutinise the practices of asset managers. It is this scrutiny, and its ability to inform manager selection decisions, that will ensure stated commitments to the Code translate into actual improvements in stewardship activity. Comparable information about the stewardship practices of different managers is vital to the development of this 'market for stewardship'.

Completing the Framework

Asset managers will be asked to self-certify themselves against the Stewardship categories within the Framework by highlighting the appropriate boxes and where possible providing a reference or link to further relevant disclosures or information below. This is to assist readers gaining an at a glance view while still providing capacity for respondents to direct the reader to supporting information avoiding responses becoming too simplistic. Furthermore, an additional box is provided if further explanations are required, for example a respondent may fall between two categories or is unable to disclose publicly certain information.

The proposed Framework does not seek to pass judgement on the particular stewardship policies and activities of the responding asset manager but provides four grades "A" to "D" for respondents to self-certify themselves against within each category. The Framework does not give different weightings to the various categories, nor award an overall grade, instead it is left to the reader to make these judgements and have further dialogue with the individual asset manager.

2. Do you agree that the suggested self-certification approach to completing the Framework is appropriate? Does it provide the reader with sufficient useful information?

The self-certification process could produce useful information for funds, provided that NAPF is sufficiently proactive in ensuring that managers provide demonstrable evidence to support their self-certification decisions, and that such evidence is made easily accessible for funds viewing the completed framework. The consultation document stresses that being in box "A" for a given category would require "a high level of demonstrable evidence", which we agree is very important. It would be helpful to clarify whether NAPF plans to actively police this (i.e. by querying self-categorisations in box A where insufficient evidence is provided) or whether this is simply an exhortation to managers whose self-certifications will not be challenged. In our view it would be wholly justified for NAPF to reject or query self-certifications where insufficient evidence is provided; indeed the self-certification framework may have limited value if NAPF does not perform this role. In addition, there should be a general expectation that managers who self-certify as having certain policies or making certain disclosures provide links to these policies or disclosures.

Clearly there are some areas in which self-certification may be more problematic than others. An obvious example is conflicts of interest. Box B requires that material conflicts are 'mitigated', but unlike Box A, does not require that they be 'disclosed'. The only difference between a categorisation in Box B and Box C is therefore the manager's own judgement that they have adequately mitigated conflicts of interest – by definition, they are not providing evidence for this. Given that Box C states that "there are unresolved conflicts remaining", it seems unlikely that any manager would voluntarily place themselves in this box.

There may therefore need to be some adjustments to the criteria on conflicts of interest if the self-certification process is to provide useful information in this category. For example, NAPF could provide examples of key conflicts which are likely to arise (such as business relationships with investee companies, voting shares in own parent company, etc) and ask managers to explain how (if relevant) these conflicts are managed. Alternatively, managers could be left to set out what they believe are the key conflicts relevant to their business model and how these are managed before they could self-certify in box B. This would at least allow funds to make their own judgements about the validity of the manager's self-certification.

Similarly, in the category on voting, box D states that managers "always follow recommendations of external voting advisory service". It is notable that in this year's IMA survey, no manager said that they did this – with only a tiny proportion having done so in previous years. This contrasts with the experience of many asset owners: for example, in the 2011 IMA survey, one is quoted as saying, "our general experience of the industry is that many (if not most) managers robotically follow recommendations". In our view NAPF should give some thought to how managers placing themselves in boxes A-C will be required to demonstrate that they scrutinise proxy recommendations in relation to significant votes. At the very least they could be asked to state any occasions on which they departed from proxy recommendations over the previous year, thus allowing asset owners viewing the information to make their own judgements.

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Given the likelihood that many asset managers will use their statements to the FRC on compliance with the Code as the basis for their responses to the framework, we would like to draw attention to our 2010 analysis of asset manager statements, 'Stewardship in the Spotlight' (available at http://www.shareaction.org/research/surveys). This indicates key areas of weakness in managers' statements (conflicts of interest being one) and may be of use in pre-empting such issues by incorporating relevant evidence or indicators into the framework categories.

Completed Frameworks

In order to encourage pension funds, and others, to utilise the completed Frameworks, the NAPF is proposing to make them publicly available on its website alongside a list (with links) of those asset managers who are signatories to the UK Stewardship Code. Part of the rationale for this approach is that the further public transparency of asset managers stewardship capabilities should help drive up stewardship standards across the market.

3. Do you agree that the completed Frameworks should be made publicly available?

Yes, we strongly agree. This is important in developing the market for stewardship as it is the only practical way to provide access to information for the full range of potential clients, as well as existing clients.

The Framework itself

The Framework attempts to reflect the Principles set out within the UK Stewardship Code. It is envisaged that to be in box "A" for any category would be very stretching and would require a high level of demonstrable evidence. The Framework has been devised to equally reflect the stewardship policies and activities of index passive investors as well as those investors with much more concentrated portfolios.

4. Do you agree that the categories included within the Framework are appropriate? Are there any categories which have been omitted?

Yes, we broadly agree that the categories are appropriate. However, we note that one category which was present in the 2020 Stewardship framework has been omitted. This is the category of 'public transparency'. In our view, as indicated above, this is vital. We appreciate that some of the requirements of this category have been dispersed across other categories, but there is still a loss of rigour in terms of many of the specific things which the original framework expected to be publicly disclosed (details of engagements, management of conflicts, internal decision making processes, etc). There is also a loss of focus on the *principle* of public transparency. This is unfortunate and we would encourage the NAPF to revisit this decision.

There might also be value in a category dealing with the application of stewardship policies to asset classes other than equities, given the reference to this in the most recent revision of the Stewardship Code ('Application of the Code', para 10).

5. Do you have any comments on the descriptors for "A" – "D" for the various categories?

We have given some comments on particular descriptors in our response to question 2. Some further comments on other descriptors are below.

Voting

In relation to disclosure of voting records, the descriptors are based only on frequency of disclosure. In our experience, based on our annual benchmarking surveys which cover voting disclosure, what sets good disclosures apart from bad is the *quality* of the disclosures. For example, some managers disclose only summary statistics about voting, which in our view does not qualify as voting disclosure since it gives no insight into how individual votes were cast. Others disclose only particular votes, such as votes cast against management. The best disclose full details of votes cast, in a searchable format, along with explanations for contentious or significant voting decisions. We understand that this analysis accords with that of others who have studied voting disclosures in detail, such as PIRC. Accordingly, our scoring system for voting disclosures awards a point for each of the following:

1. disclosure of all votes

2. listed by company and proposal

3. rationales provided for votes against management / abstentions

4. rationales provided for all contentious votes (regardless of voting decision)

We would suggest that the framework could be improved by incorporating some indication of the quality or extent of voting disclosures into this category.

In relation to voting more generally, the descriptors refer to the percentage of portfolio holdings which are voted, but it is not entirely clear if this refers only to UK equities or to all equities. Since the latest version of the Code encourages investors to apply the Code to their overseas equity holdings on a 'best efforts' basis, in our view there should be some reference to this in boxes A and B at least. If the percentage descriptors are intended to refer to all equity holdings, and not just UK equities, this should be made explicit, since otherwise the descriptors may be interpreted in different ways, leading to inconsistent self-categorisations by different managers.

Conflicts of interest

As already indicated in response to question 2, we think the wording regarding conflicts of interest policies could be improved. Both we and the FRC have identified the quality of conflicts of interest policies disclosed under the Stewardship Code as an area for concern. The criteria could therefore incorporate some reference to the quality or extent of policies in order to achieve an 'A' certification, rather than simply the existence of a policy. Similarly, it requires only that there are 'processes' in place to manage conflicts, rather than *robust* processes (in line with the wording of the Code itself). In our most recent submission to the FRC, we suggested that a good policy would be one which identified key sources of potential conflict and explained the process in place to manage them. Disappointingly few conflicts policies currently do this. We would suggest that managers should have to provide, or link to, this information before they can certify themselves in box A.

ESG integration and engagement

We strongly welcome the inclusion of specific descriptors on integrating ESG and on escalation of engagement activity, in particular the reference to willingness to attend AGMs and use shareholder resolutions. We also note that the descriptors on escalation and on compensation have been tightened and improved in comparison to the original 2020 Stewardship framework.

Assurance

The reference to independent assurance is also welcome and important. In line with the FRC's finding that many firms are not making assurance reports available to clients on request, we would suggest that such disclosure should be a requirement in order to self-certify in the higher grades. In particular, given that the framework is primarily intended to assist *prospective* clients, public disclosure of assurance reports should be expected in order to self-certify in box A.

Other

6. Do you have any further comments?

Further comments on the evolution and application of the Stewardship Code are available in our response to the FRC's most recent consultation on the revised Code, on our website at http://www.fairpensions.org.uk/sites/default/files/uploaded_files/StewardshipCodeReview2012.pdf
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Please direct all responses to Will Pomroy, Policy lead: corporate governance, NAPF at will.pomroy@napf.co.uk / Cheapside House, 138 Cheapside, NAPF, London, EC2V 6AE by **COP** 5 **July 2013.**

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