Building better connections

Abigail Williams explores how those managing pension schemes can best align their sustainable investment principles with the actions of their asset managers

Summary

• According to many observers, asset managers wield significant influence over how public companies are run, and their actions impact corporate governance in a profound sense.

• There is a growing recognition of the importance of direct voting rights, since they allow schemes as asset owners to exert influence over simple changes companies can carry out to improve ESG performance.

• Some observers urge schemes to introduce strong policies on net zero, exclusions, stewardship and DEI, and only appoint asset managers that are willing and able to comply with and report against these policies on a long-term basis.

As socially responsible investing grows in importance, an increasing number of pension funds are considering how best to improve connections with asset managers, especially in relation to the alignment of sustainability and ESG investment principles when voting at company AGMs. So, how can pension schemes and trustees encourage their appointed asset managers to take their investment principles into account when carrying out their activities and voting at AGMs? What can they do during the appointment process to ensure their principles will be followed? And, are any changes needed to allow investors more influence on voting?

Driving change

According to Smart Pension chief investment officer, Paul Bucksey, asset managers wield significant influence over how public companies are run, and their actions impact corporate governance profoundly. In this light, he observes that direct voting rights are important since they allow schemes

as asset owners to have some influence over the simple changes companies can carry out to make a big difference – for example by lowering their carbon emissions, reducing harmful waste and improving their sustainability processes.

"Ultimately, asset owners need to be given the chance to voice their opinions and exercise their rights on important topics," he says.

"Many DC schemes invest via pooled funds whereby there are no voting rights. However, we have pass-through voting on a fund we recently seeded with AMX-DWS, one of the first in the DC space to do this. Pass-through voting on pooled voting can also be a useful way of engaging with our members on topics important to them. Our ambition is to broaden this out to more of our investments," he adds.

Elsewhere, EQ Investors head of sustainability, Louisiana Salge, explains that, as a sustainable wealth manager, the company uses its relationship with asset managers to engage them on using stewardship powers to drive positive change, by engaging on strategic themes that it considers can add value or address a specific shortcoming in the existing stewardship process of the manager.

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"If you do not have enough experience in sustainable investing, you can leverage the public reports by the likes of ShareAction. Their RISE papers provide examples of best practice in asset management on various topics, and their investor ranking work helps you contextualise asset managers' performance on stewardship compared to their peers. This resource can be shared with the asset managers and provide the basis for driving engagement," she says.

Meanwhile, AXA Investment Managers head of UK institutional sales, Rachel Bussell, believes it is important that schemes understand their managers' processes for voting and engagement. She urges schemes to "look at the quality of the engagement by asset managers and not just the statistics".

"This is about driving change and working with companies as part of the transition. Managers should be able to give case studies to schemes on voting and engagement to demonstrate their experience on driving change. They should also be able to discuss what has happened when companies haven't met their KPIs," she says.

"If a scheme has strong views on certain topics, they should be able to have an open dialogue with their manager on this and how it can be incorporated. This is about driving change together as an industry," she adds.

Stewardship approach

When it comes to stewardship assessment, Salge suggests that funds undertake due diligence on three levels when deciding on appointments. To begin with, she urges investors to make their intentions clear when it comes to engagement, for example by indicating they would like to support pro-environmental and social resolutions. She also recommends that funds assess whether potential asset managers have the internal resource, processes, and policies to match that intention and urges them to look at existing evidence from their voting record, as well as their engagement reports, to show whether they were able to deliver it previously.

"You may want to include questions on 'engage-ability' into the initial due diligence with an asset manager, to understand how interactive the relationship is intended to be. Furthermore, the level of transparency and reporting provided to you by the asset manager is also important as this is the basis upon which you can then engage," she says.

According to Redington head of stewardship and sustainable investment strategy, Paul Lee, "it is hard to retrofit aligned stewardship and voting to an existing relationship with a fund manager", meaning it is vital that asset owners "build in an assessment of the manager's stewardship approach as part of the appointment process".

"That means both assessing the processes and systems that managers have in place for delivering good stewardship outcomes and reviewing the quality of the actual stewardship activity through case study discussions of engagements with significant exposures for the fund in question," he says.

"Choosing a manager at least in part because their stewardship approach is more aligned with the asset owner's view is more likely to lead to their activities in future aligning with the client's perspective and principles," he adds.

Are changes needed?

According to Bucksey, some asset managers have already taken steps to enable their investors to choose how they want to vote, and he urges more of them to offer this flexibility, ensuring capital owned by investors is voted on in accordance with their stated values.

"New technology has made client-directed voting possible, giving asset managers the ability to afford the same voting rights to clients across both segregated and non-segregated mandates. However, there needs to be greater access to this across the industry. We also welcome FCA, DWP, FRC and other UK policy efforts to support investors in undertaking robust stewardship," he says.

Meanwhile, Salge notes that most asset managers apply a voting policy and engagement strategies "at the whole firm, rather than strategy-by-strategy" – meaning they "should publicly display their voting activity in a detailed and timely manner, so clients can take it into consideration when appointing and engaging managers".

"Secondly, pass-through-voting is a new way of expressing voting intentions directly as the client, which some asset managers already offer. Thirdly, even if the voting rights remain with your appointed manager, you can still engage directly with underlying companies through collaborative initiatives and can arrange to go to the AGMs of investee companies to ask questions to the board directly," she adds.

Ultimately, Lee notes there is a real challenge in making sense of voting from the asset owner's perspective – particularly since there are tens of thousands of individual resolutions across most equities' portfolios at the asset owner level, meaning that a client will often find that "more than one of its managers has voted at the same AGM, potentially differently, in effect cancelling each other out".

"Making sense of this weight of data from the asset owner perspective takes a technology tool, but it is necessary if clients are to understand voting from their aggregated perspective, rather than having individual perspectives from each of their managers, and necessary for clients to be able to hold their managers to account effectively for their decisions," he says.

"Once it's possible to challenge and hold managers to account for their decisions, clients will be better able to influence their future decision-making and help it shift to being more aligned with their views," he adds.

Written by Abigail Williams, a freelance journalist