LCP INSIGHT CLARITY ADVICE

Raising the bar

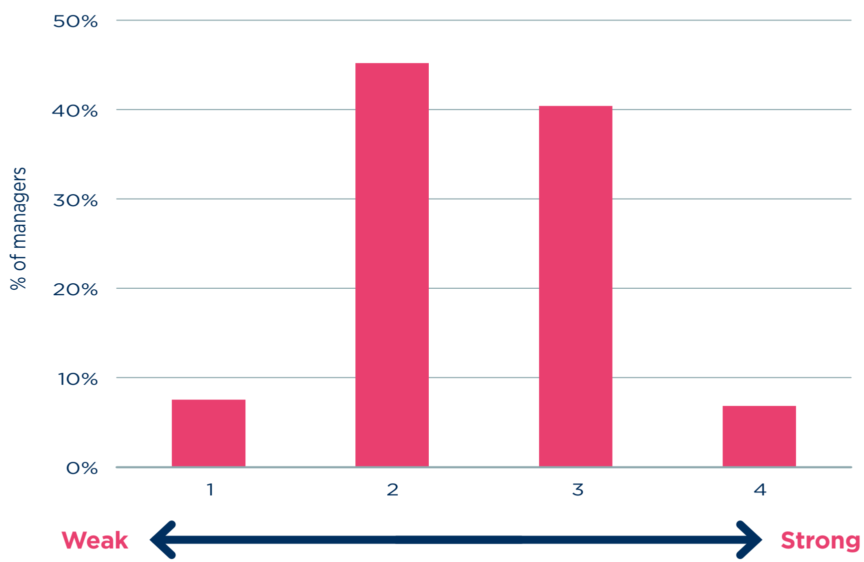
LCP Responsible Investment Survey

January 2022

At a glance

146 investment managers completed our 2022 survey

Manager-level scores from LCP RI survey



Being a PRI[1] signatory is now an expectation

66% in 2016

78% in 2018

88% in 2020

96% in 2022

Mandatory RI training is lacking at board level

69% of managers have mandatory training for staff

23% of managers have mandatory training for board members

***22%** of managers adjust third party data a little or not at all*

despite well-known concerns about the quality of ESG data

***36%** of managers have already published a TCFD[2] report*

Use of climate scenario analysis is encouraging

Broadly **70%** of managers are using climate scenario analysis to some extent in investment decision making, although typically not for all their strategies

[1] Principles for Responsible Investment [2] Taskforce on Climate-related Financial Disclosures

At a glance
continued

Net zero targets are gaining traction

42% of managers are working towards net zero for all assets under management, although their plans to achieve this are at an early stage

Climate change and board effectiveness dominate engagement agendas

66% and **71%**

of managers frequently engaged on climate change and board effectiveness respectively

Engagement is a key priority for managers, but practices could be strengthened

42% of managers do not have a formal escalation policy to help them more quickly achieve their engagement objectives

Managers are making their voices heard

On average, listed equity managers:

exercise 97% of votes

and vote against management or abstain at least once at 36% of AGMs

Systemic change is required to meet ambitious goals

90% of managers stated that they engage with policymakers or regulators on industry-wide topics

Foreword

There is no going back — no matter what we do now, it's too late to avoid climate change and the poorest, the most vulnerable, those with the least security, are now certain to suffer.

Sir David Attenborough

But as startling as that sounds, Sir David Attenborough also called upon leaders at the COP26 summit in Glasgow to be "motivated by hope rather than fear" to avoid climate catastrophe.

Climate change, as a particularly high-profile responsible investment topic, is now widely accepted as being financially material, presenting significant risks and opportunities to investments over the short to medium term, as well as the long term. Most managers have only very recently been looking seriously at reducing portfolio carbon emissions. However, progress has been so rapid in this area that focus is already starting to shift towards how managers can best support achieving real-world emission reductions.

Investors have a crucial part to play in mitigating climate change, but also in backing responsible investment more broadly. With post-COP 26 analysis and debate still very much on people's minds, we have to remind ourselves that responsible investment is not just about climate change. And even if we were to simply focus on climate change, investors would soon see how this spills over into broader consideration of environmental, social and governance (ESG) factors, including the need for a just transition. This broader perspective is needed to facilitate the transition to a lower carbon economy in an equitable way for all, that makes the end goal more likely to be achieved and uses the opportunity to effect wider societal benefits.

The rising prominence of responsible investment (RI) has accelerated over the last couple of years, with best practice evolving rapidly, reflecting changing investor preferences, increasing regulation and growing recognition of RI's importance for investment outcomes. But this is not just about the investment community talking to itself. Broader society is becoming increasingly engaged with E, S and G, or at least significant elements of these factors - as examples, climate change clearly (E) but also diversity (S) and fairness of executive remuneration (G). All investment professionals have a role to play in addressing these E, S and G issues, with investment managers playing a leading role in engaging with companies on these matters on behalf of asset owners and society more broadly.

This has been recognised by the growing focus on stewardship with increasing expectations for asset owners, asset managers and service providers, most significantly via the step change in expectations detailed in the UK Stewardship Code 2020. Properly exercised, stewardship is acknowledged not just as a method of improving investment returns and reducing risk, but also as a means of creating for long-term sustainable benefits for the economy.

Investors have a crucial part to play in mitigating climate change as well as backing responsible investment more broadly.

Foreword
continued

With this rapid evolution, investors' expectations of investment managers are now higher than ever as the bar is continuously raised to keep pace with the latest developments. The challenge this poses is reflected in the results of this year's survey which show a decrease in the proportion of managers achieving the highest grades. Nevertheless, as this report illustrates, at the aggregate level there have been significant improvements in managers' RI practices since our last survey in 2020, with the number of managers being awarded the lowest score also reducing, slightly. It is pleasing to see many managers taking clear action to develop their RI policies and practices.

Investors' expectations of investment managers are now higher than ever as the bar is continuously raised to keep pace with the latest developments.

Some of the key points we have uncovered are:

- **Managers are taking ESG issues and stewardship much more seriously**. This is reflected in their reasons for considering these, as well as the training and resource that they are dedicating to RI. However, we would like to see more evidence that this focus is being led from board level.
- **Significant progress has been made in monitoring and assessing climate-related risks**. Many managers are now going even further, setting their own net zero targets – we expect this to be a growing trend, and look forward to seeing more detail of how managers are planning to achieve their targets.
- **Voting practices remain strong and continue to improve but the wider engagement agenda is still somewhat skewed**, mainly to climate change and governance issues. Going forwards, we would like to see managers engaging on wider social and environmental issues to a greater extent.

We expect to continue to raise the bar on what we view as best practice responsible investment. Managers should show that they are genuinely embedding RI considerations throughout their entire investment process, and continually striving to improve so they keep above that ever-increasing standard.

Asset owners are taking a greater interest in understanding how their managers are addressing RI issues within their investments and are actively engaging with their managers, with the help of their advisers, to understand how ESG factors are integrated into portfolios and how stewardship is being exercised on their behalf. We conclude this report with some key actions for asset owners to assist with this ongoing dialogue.

Claire Jones

Partner and Head of Responsible Investment

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About our survey

This is our sixth, biennial responsible investment survey

Every two years we invite a wide selection of investment managers to complete an in-depth survey about **responsible investment (RI)**.
It covers:

- their approach to **environmental, social and governance (ESG)** issues; and
- their **stewardship** practices, such as exercising **voting** rights and **engaging** with company management.

We analyse each manager's responses and assign the manager a score between 1 (weak) and 4 (strong). This report summarises the findings.

Some of the questions and scoring used are the same as our previous surveys, so we can compare results. However we have also asked a significant number of new questions. In particular, our expectations of managers around climate change and stewardship have risen significantly, so we have asked more specific questions on these topics and these form a larger part of our report this year.

Our survey covers the managers' general approach to RI. However, there are usually differences in implementation between different funds and strategies offered by the same manager. When we form an opinion on a particular strategy, we therefore supplement the survey results with specific research into the RI approach of that strategy, which we use to assign a strategy-specific RI score (on the same 1 to 4 scale). RI is a standard agenda item in our meetings with managers, where we probe what they do in practice.

The numbers:

For the 2022 survey, **146** investment managers completed our survey out of 173 invited. The majority of responses are from UK-based investment managers, including the major institutional UK managers, but we are seeing similar trends of significant progress in RI approaches globally. Most managers completed the survey in August and September 2021.

We make comparisons with the survey results from 2018 (120 responded) and 2020 (148 managers responded).

Some managers did not answer every question in the survey. The percentages quoted are for the managers answering the specific question, so the number of respondents is usually slightly lower than 146.

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Indicators of high-quality responsible investment practices

What we look for in managers

Here we summarise some key indicators of high-quality responsible investment practices. This is not an exhaustive list and we recognise that not every indicator is relevant to every manager. Throughout the report, we explore how managers currently measure up against some of these indicators, based on their responses to our survey. We do not cover all of them as some are better suited to one-to-one discussions with managers.

For all indicators, dialogue is valuable in probing the managers' responses and obtaining a more thorough understanding of their practices.

Commitment to RI

- Show RI leadership at the highest levels of the firm
- Are a signatory or member of relevant codes and initiatives

People

- Hold senior management accountable for ESG integration and stewardship
- Include RI as part of investment professionals' job descriptions
- Train all relevant people on RI including board members
- Have specialist staff providing in-depth RI expertise as required

Investment process

- Integrate ESG throughout the investment process
- Ensure ESG considerations affect buy/sell decisions
- Consider multiple sources of ESG data, taking all reasonable steps to ensure its quality and robustness
- Undertake analysis of ESG risk exposure at the portfolio level for all asset classes

Climate change

- Embed climate-related risks and opportunities throughout the investment process
- Monitor both climate transition risk and physical risk metrics in portfolios
- Routinely utilise climate scenario analysis to understand and assess the risks
- Seek real world reductions in emissions
- Work towards net zero emissions with appropriate interim targets
- Report climate-related metrics to asset owners for all assets

Stewardship

- Use voting and engagement as tools to improve investment performance
- Have robust policies on engagement with respect to a variety of ESG issues
- Have an escalation policy to be called upon in cases of unsuccessful engagement
- Form a view on voting decisions, rather than relying on proxy advisers
- Exercise all votes and be willing to vote against management
- Report to investors regularly on voting activity
- Can provide evidence of strong collaboration, as appropriate, with other investors
- Engage with policymakers and regulators on economy- and industry-wide topics

The period since our last report has been thought-provoking and challenging, for many on a personal level, but also in the investment sphere. World events have meant that, although responsible investment was already a developing area, there are now growing expectations of managers' abilities to assess and monitor investment risks related to a wider range of ESG issues. We assess managers against these higher standards, and help our clients to engage with them to help drive the improvements that are needed to reach those standards.

Sapna Patel
Senior Consultant

The results: ESG integration

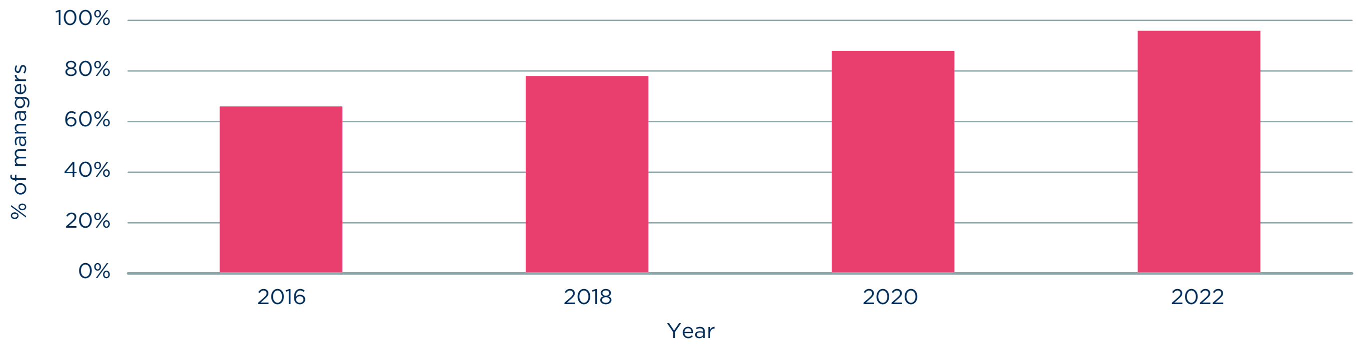
Managers have integrated ESG into their investment processes

Our survey results indicate that most managers are embracing the need to integrate **ESG** into their investment process, rather than simply paying lip service to it.

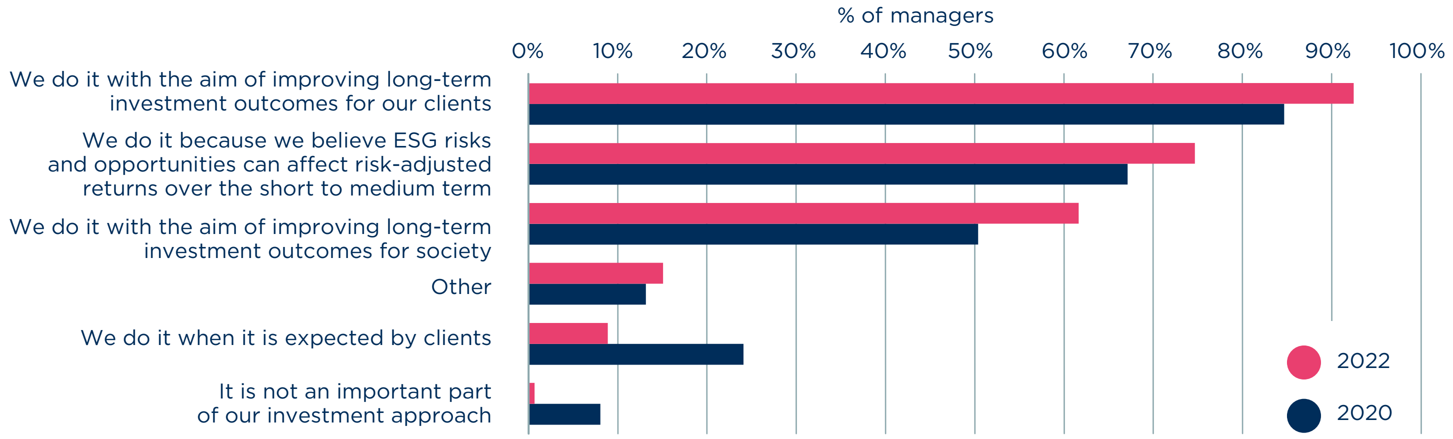
The proportion of managers who say ESG integration is not an important part of their investment approach **has fallen from 8% in 2020 to 1%**, but what is interesting is the shifts in the reason for their approach. The proportion of managers who say they integrate ESG because it is expected by clients rather than for investment reasons **has fallen from 24% to 9%**. There is now greater support for using ESG integration to improve outcomes for clients, and also for society as a whole.

The number of managers now signed up to the **PRI** has changed materially over the last six years, **from 66% in 2016 to 96% currently**.

Proportion of managers who are PRI signatories



Manager approaches to ESG integration



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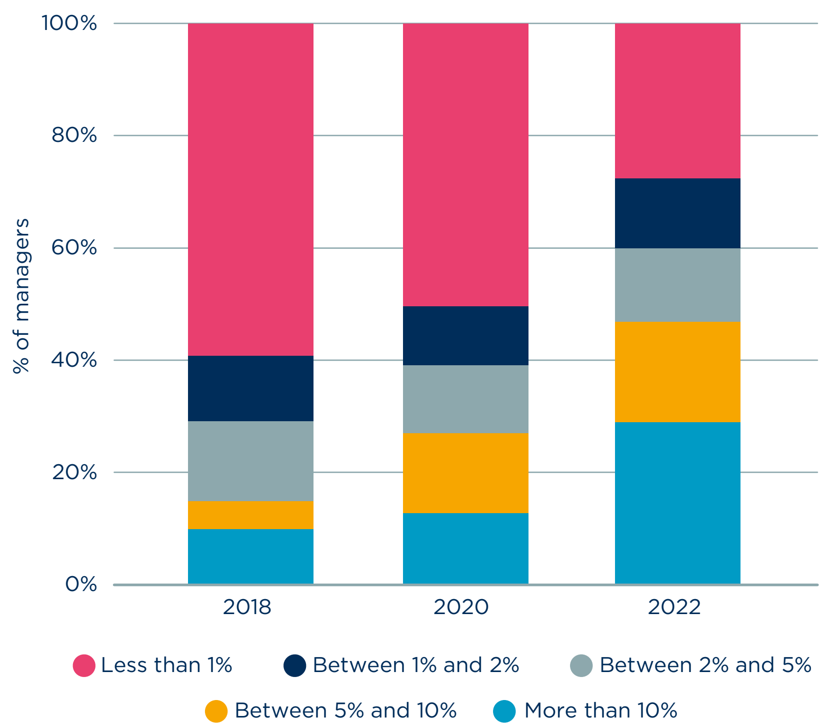
ESG integration – people

Managers are dedicating even more resource to responsible investment

Managers have significantly increased the level of resources and training dedicated to **ESG** and **stewardship**, hiring more specialists to meet the growing demand for expertise in this area. We can see progression since our 2018 survey, although the biggest leap has been in the last two years.

The proportion of investment professionals that are now ESG or stewardship specialists[3] has more than doubled over just two years – **in 2020 13% of managers** had more than 10% of their investment professionals in these roles, **and now this figure is 29%**. Similarly, the percentage of managers for whom the proportion of specialists was less than 1% **has nearly halved from 50% to 28%**. This is a welcome development which should help managers keep up with clients' demands for a well-resourced approach to managing ESG issues and stewardship.

Proportion of managers' investment professionals that are ESG and/or stewardship specialists[3]



[3] Defined as over 50% of their role having ESG and/or stewardship responsibilities or they hold a relevant qualification.

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ESG integration – people

Board members should be held accountable for responsible investment oversight, but are they up to the job?

We expect managers to have board level oversight and accountability for **responsible investment**, yet we found that **33%** of managers had no one at board director level with responsibility for the oversight of **ESG** and **stewardship**. Furthermore, when we asked about training in responsible investment, we were told this is mandatory for all relevant staff at **69%** of managers, however for board members, the equivalent figure is **23%**. This is important because if the board is to carry out robust oversight of responsible investment practices, it must have a good understanding of these issues.

More broadly, consideration of responsible investment issues should be recognised as a job for all investment professionals, not just RI specialists. For example, non-specialist investment professionals should be incentivised to address ESG and stewardship explicitly as part of their day job. For **46%** of asset managers, more than half of their investment professionals have performance objectives that are explicitly linked to ESG and/or stewardship considerations. It was a similar picture for remuneration. However, only around **30%** of managers include RI in the job description for most of their investment professionals. This still represents a significant development, as the corresponding figure for ESG and/or stewardship being explicitly linked to remuneration and/or performance objectives was only **21%** in 2020.

Overall, while more investment professionals appear to include RI as part of their role now, it's interesting that the increased focus is not being translated to board level yet.

Proportion of managers' investment professionals that have ESG and/or stewardship explicitly linked to their...

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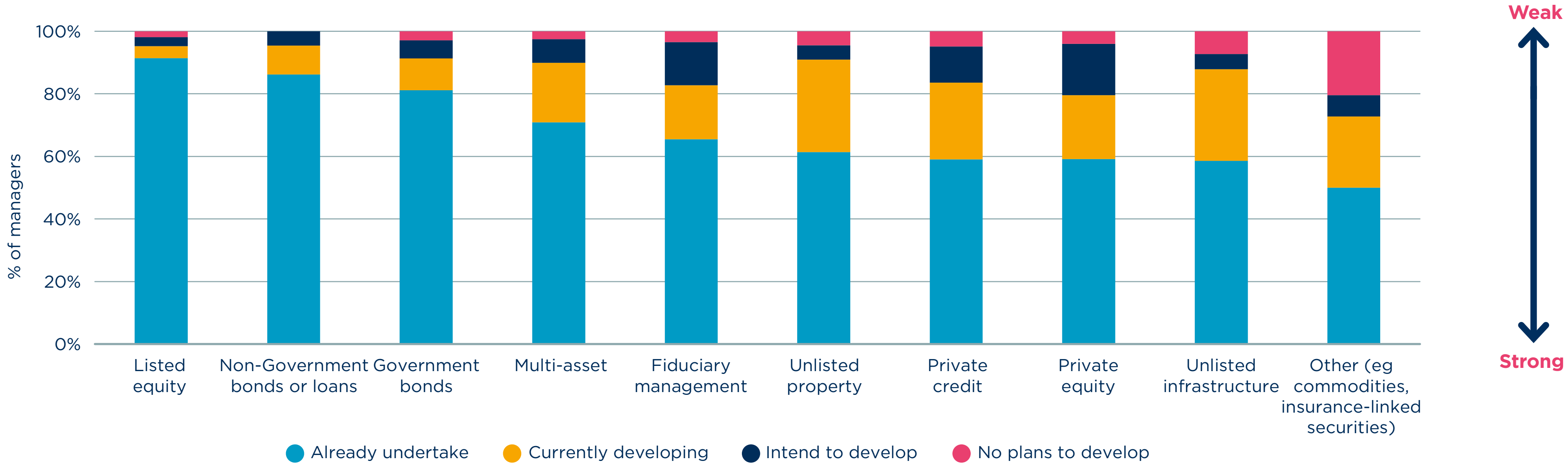
ESG integration – data and analysis

Managers have made good progress analysing ESG risks at a portfolio level

There has been an increase in the amount of portfolio-level analysis on **ESG** risks – in particular, this has increased significantly for listed equity, bonds (both government and corporate) and multi-asset mandates. For example, amongst listed equity managers, **91%** are already undertaking portfolio-level analysis compared to **74%** two years ago, and for non-government bonds this number has risen to **86%** from **70%**. Where this analysis is not already embedded in the investment process, managers say they are either currently developing, or have plans to develop, portfolio-level analysis of ESG risk exposures for most asset classes.

Proportion of managers by asset class undertaking or developing portfolio-level analysis of ESG risk exposures for the majority of strategies



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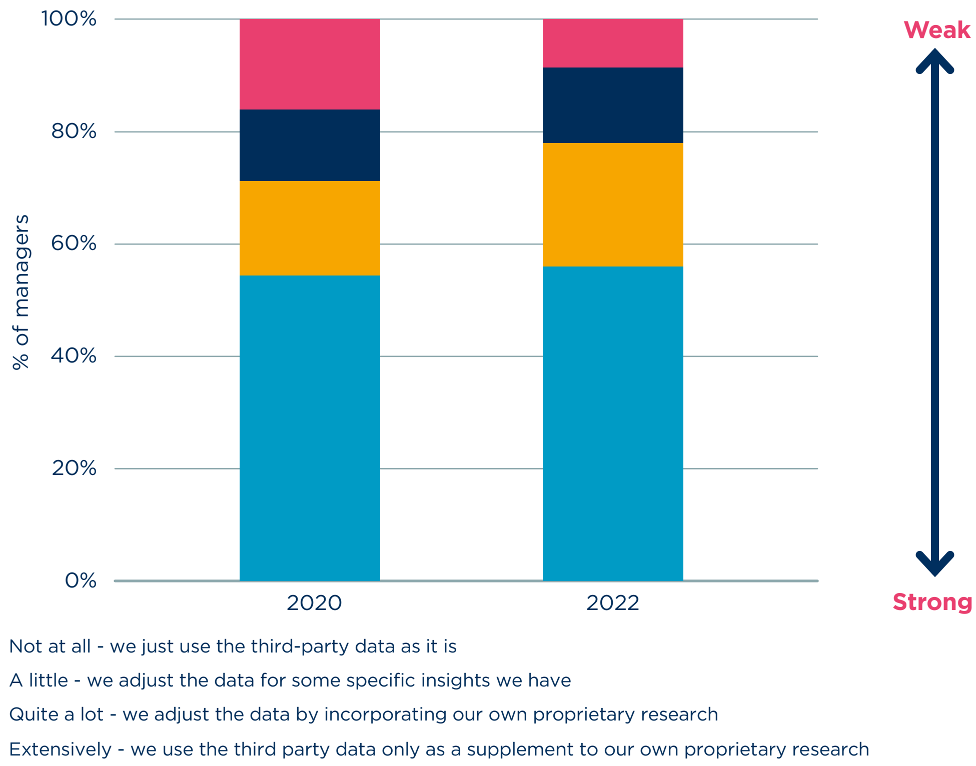
ESG integration – data and analysis

Are managers adequately scrutinising third party data?

It is widely acknowledged that **ESG** data provided by third party providers requires close scrutiny and careful use to ensure that it is consistent and appropriate for its purpose. Managers continue to cite the availability and quality of ESG data as two of the biggest challenges associated with embedding **RI** in their strategies, often noting a lack of consistency between data providers' ESG scores. Although there has been some progress in the steps that managers are taking to ensure data quality, there is certainly further to go. **22%** of managers say that they adjust third party data only a little or not at all, which we believe requires challenge.

Extent to which managers adjust third party ESG data using in-house analysis



We now expect ESG considerations to be integrated into all investment mandates in order to improve investment returns and manage risk. In our manager research, we look for evidence that ESG factors are part of the investment process, with sufficient attention given separately to environmental, social and governance factors. We expect managers to use their own proprietary research to complement third party ESG data. It is important for us to see examples of how ESG considerations have affected investment/divestment decisions in practice.

Matt Gibson
Partner and Head of Investment Research

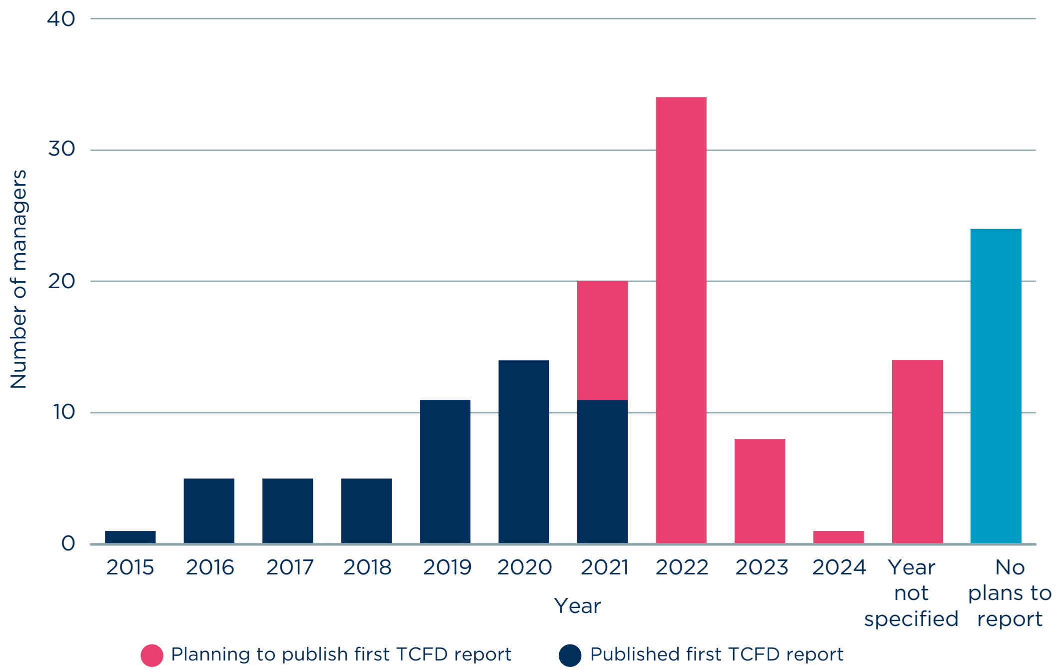
Climate change – commitment

Managers are addressing climate change, in many cases ahead of regulatory requirements

Politicians and society at large accept that climate change needs to be addressed. Since our 2018 survey, a lot of effort has gone into understanding and assessing climate risks to investment markets. As more data has emerged, many investors are now looking at modelling the possible effects of climate change on their investment portfolios. Investors expect their asset managers to consider and appropriately manage **climate related risks and opportunities** for their assets, including those arising from both the transition to a low carbon economy and the physical impacts of climate change.

There are encouraging signs that managers are making good progress in this area and doing more than simply what is required of them from a regulatory standpoint. For example, **36%** of managers have already published firmwide **TCFD (Taskforce on Climate-related Financial Disclosures)** reports, including disclosures on the impacts of climate change across their businesses. This is despite there not yet being any regulatory requirements for them to do so (although these are being introduced for UK-regulated investment managers from 2022 – for more information on this, see the following page). Another **47%** intend to do so in the future, with the majority planning to do this by 2023.

Year managers published, or are planning to publish, their first TCFD report



At the time this survey was carried out, only **34%** of managers had signed up to the **Net Zero Asset Managers Initiative**, which launched in December 2020. However, by November 2021 this number had increased to **44%**. In comparison, **48%** of managers are involved in Climate Action 100+, a global investor collaboration that engages with the world's largest corporate **greenhouse gas** emitters to ensure they take the necessary action on climate change. We expect the number of managers signed up to these initiatives to continue to increase as managers seek to demonstrate they're taking climate change as seriously as they claim they are.

Climate change – what's new for asset owners?

LCP has signed up to the Net Zero Investment Consultants Initiative which commits us to integrating advice on **net zero** alignment into our investment consulting services by September 2023, reducing our own **emissions**, and engaging with regulators and the industry to break down barriers to a net zero future. You can read more about our approach to climate change here.

LCP will require investment managers to have joined the **Net Zero Asset Managers Initiative** by 1 April 2022 to be eligible for a "buy" rating. We regard this as a minimum standard to ensure that the systemic financial risks from climate change are being addressed. In practice, we expect managers to go beyond this by proactively managing **climate-related risks and opportunities** to their clients' portfolios over both the short and long term. We have published a set of net zero expectations for investment managers.

The UK Financial Conduct Authority (FCA) is introducing **TCFD**-aligned disclosure requirements for the asset managers it regulates. Asset managers will be required to publish an annual entity-level TCFD report on how they take climate-related risks and opportunities into account in managing or administering investments on behalf of clients.

In addition, firms will be required to produce a baseline set of consistent, comparable disclosures in respect of their products and portfolios, including a core set of metrics. These new rules apply to managers with over £50 billion assets under management from 1 January 2022, with their first reports due by 30 June 2023, and managers with over £5 billion one year later.

These rules will be welcomed by asset owners, from pension schemes to insurers, charities and foundations to sovereign wealth funds, who are all keen to understand how their investment managers are managing these risks. They will also help those UK pension schemes with over £1bn of relevant assets which are required to produce their own TCFD reports with climate-related metrics for their assets. However, the rules will not be early enough for the first year of reporting for most schemes.

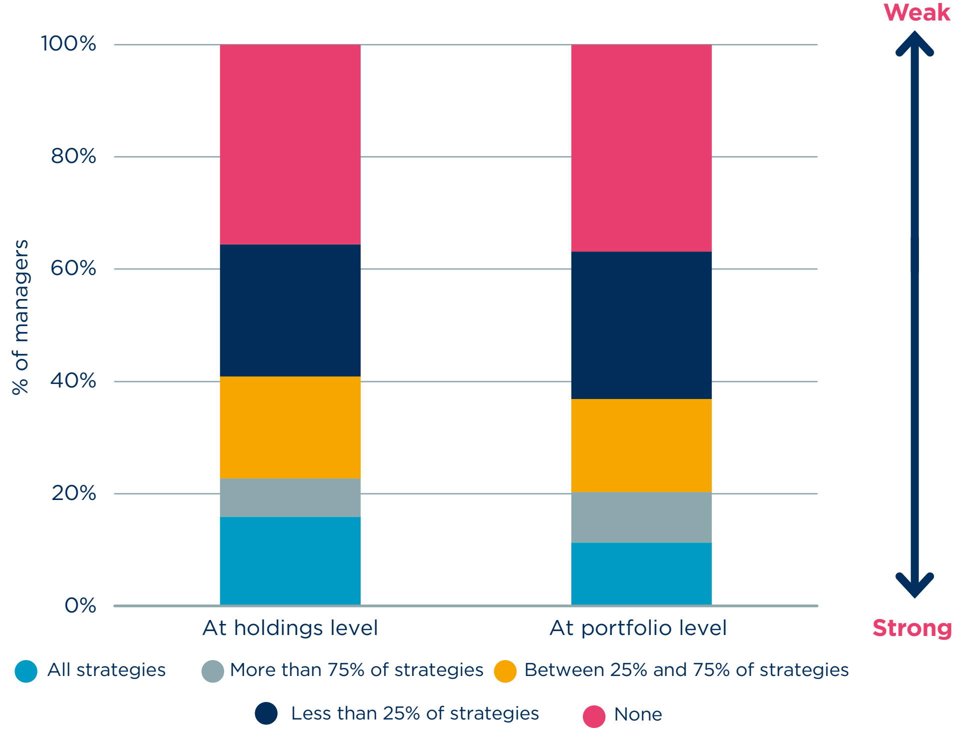
Climate change – analysis and reporting

Managers are making strides in climate scenario analysis

The purpose of climate scenario analysis is to consider different climate pathways that might unfold, exploring a range of different temperature outcomes and different combinations of policies and technologies to get there. We believe that any robust approach to managing **climate-related risks and opportunities** should include scenario analysis both for individual holdings and at portfolio level. This is because it builds understanding of how investments might be affected and helps to identify and assess climate-related risks and opportunities.

We questioned managers on their approach to climate scenario analysis. We found that **broadly 70%** of managers are using climate scenario analysis in investment decision making to some extent, for individual holdings and/or at portfolio level. For the vast majority of managers, where they are carrying out this analysis at a holdings level, they are also carrying it out at the portfolio level. These results are encouraging, even though the extent and quality of climate scenario analysis will vary from manager to manager. We would expect to see these numbers increase further over the next couple of years and cover a higher proportion of strategies.

Extent to which managers use climate scenario analysis in investment decision making at the holdings/portfolio level



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Climate change – analysis and reporting

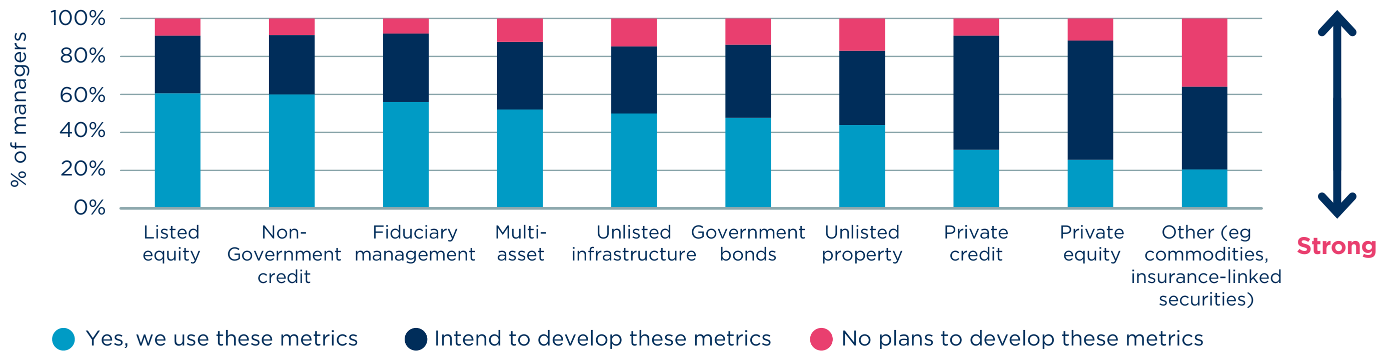
Managers are monitoring both physical and transition risks and opportunities in their portfolios

Investors should be considering both **transition and physical risks and opportunities** when addressing climate change. We asked managers whether they use metrics to assess these types of risks and opportunities in portfolios, and the answers were encouraging. A good proportion of managers are already using transition and physical metrics across most asset classes, and they intend to develop them for the majority of the remaining portfolios.

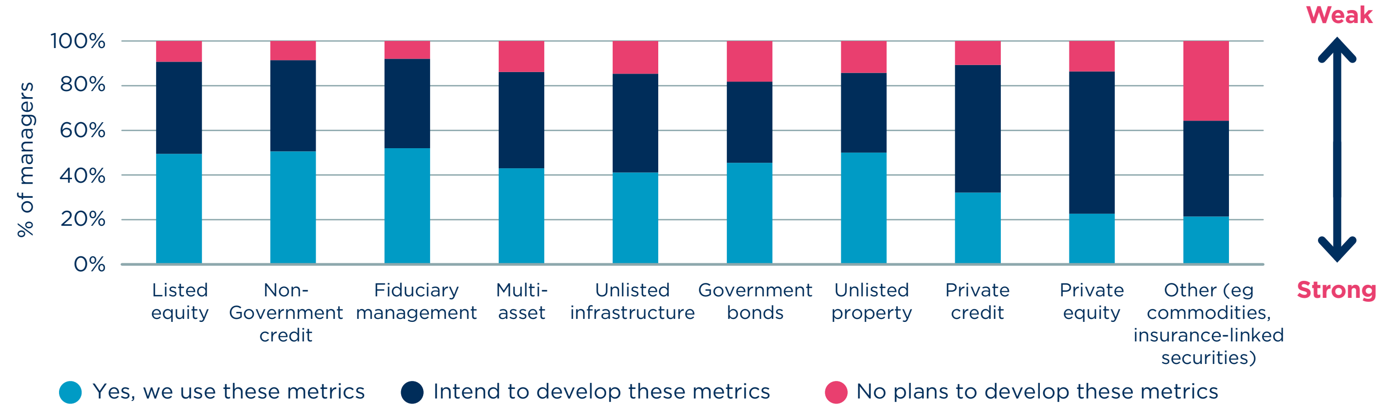
Physical metrics are used less than transition metrics for all asset classes with the exception of unlisted property. This is what we would expect – there is still significant progress to be made across the industry in developing metrics that capture physical risks in a meaningful way because physical risks are generally location-specific, making it harder to collect and aggregate the data.

We are not surprised that the use of both physical and transition metrics is more limited in private markets, where the volume and quality of reporting is lower compared to public markets. Nonetheless, it is disappointing and worrying: managers often have direct relationships with private companies, enabling them to request the data, and the illiquid nature of their investments makes the data more important. As data quality and reporting coverage from companies improves over time, we expect to see further progress.

Proportion of managers by asset class using climate transition metrics to assess and manage relevant climate-related risks and opportunities across the majority of strategies



Proportion of managers by asset class using physical climate metrics to assess and manage relevant climate-related risks and opportunities across the majority of strategies



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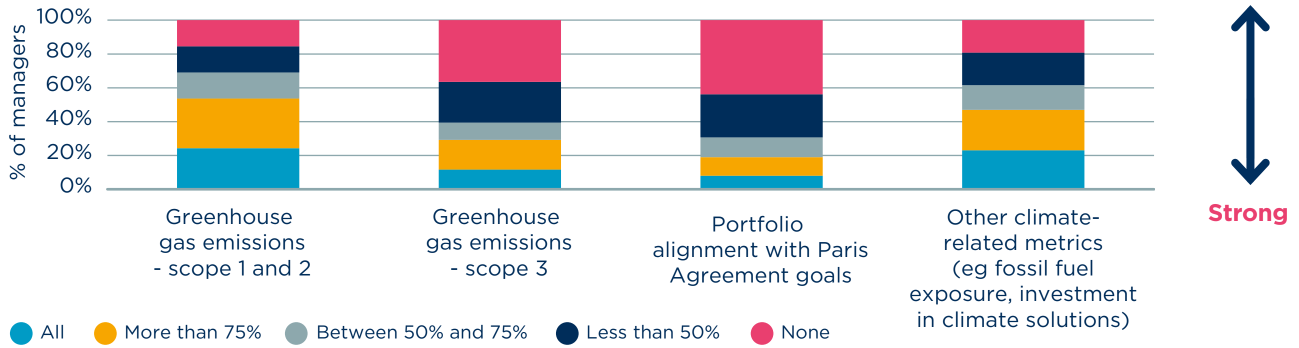
Climate change – analysis and reporting

Reporting needs to catch up with analysis

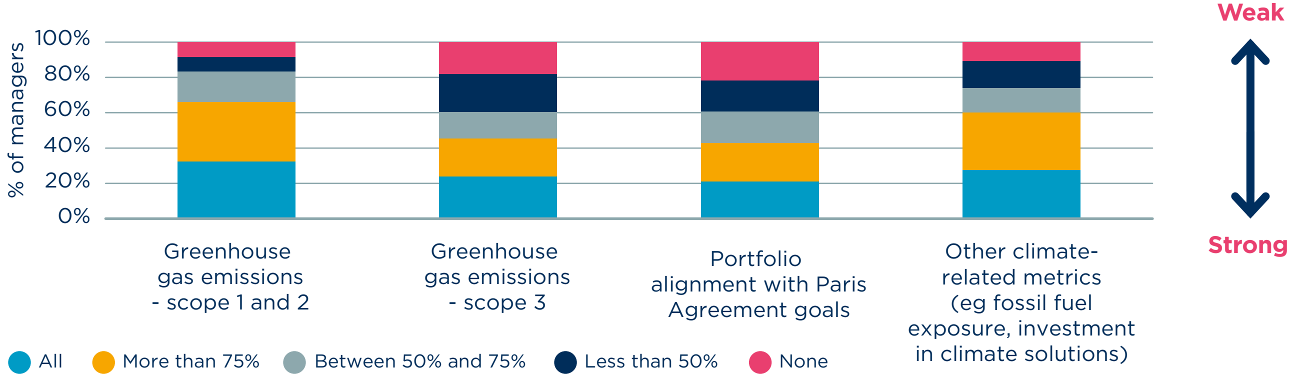
There is an important distinction to make between the metrics that managers use in their investment process to manage climate risk, and the metrics that they provide to clients invested in their strategies. While it is vital that managers monitor climate-related metrics to understand the **risks and opportunities of climate change** to their investments, their ability to report on climate-related metrics is also becoming more important as both clients and regulators demand this.

The progress managers have made on monitoring climate-related metrics has not yet directly translated to reporting for clients. For the most part coverage is still relatively limited, although managers expect to make significant progress by the end of 2022. However, a significant minority of managers anticipate that even by then, they won't be able to provide climate-related metrics covering at least 50% of the portfolio value for any strategies, in particular for **scope 3** emissions **(18%)** and for alignment with the goals of the **Paris Agreement (22%)**. Asset owners will be hoping that managers can exceed these targets whilst investment managers will be hoping that they have sufficient good quality data from their underlying holdings to meet them.

Proportion of strategies for which managers can provide investors with climate-related metrics covering at least 50% of the value of the portfolio



Proportion of strategies for which managers expect to be able to provide investors with climate-related metrics, covering at least 50% of the value of the portfolio, by the end of 2022



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Climate change – net zero

Managers are working towards net zero, but need to put in place clear plans to achieve it

Whilst achieving the goals of the **Paris Agreement** on climate change is in the long-term best interests of society overall, we also believe that it is in the best interests of long-term investors. This will require achieving **net zero greenhouse gas emissions** by 2050 or earlier. With many governments and corporates making significant commitments to meet this goal, investors are seriously considering how this relates to their investments, with many now thinking of setting net zero targets for their own portfolios. It is therefore important to understand how managers can help investors reach their targets.

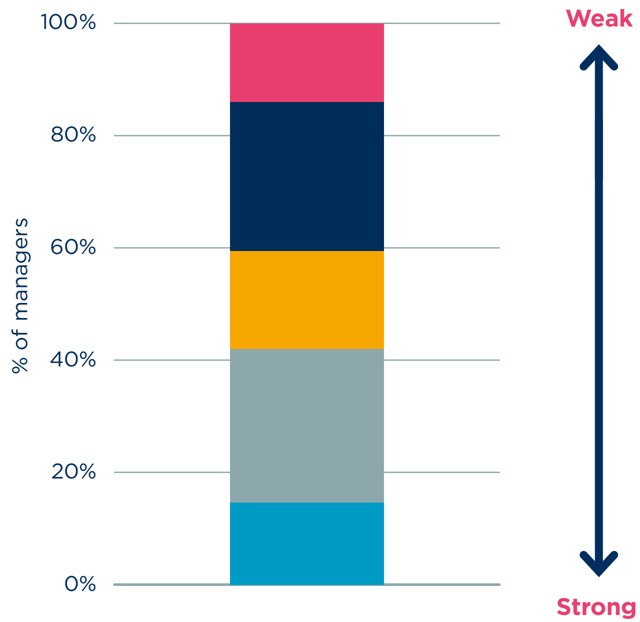
At the time of our survey, **41%** of managers said they had either not considered, or had decided not to set, a net zero target at all. However, **42%** of managers were working towards net zero for all assets under management.

While it is encouraging that managers are signing up to the **Net Zero Asset Managers Initiative**, which commits them to working towards net zero emissions by 2050 for all assets under management (see page 17 for more information), this is only the first step – they need to set and implement clear plans to reach net zero, which includes increasing the proportion of their assets that fall under this target and setting interim emissions targets for each strategy. These interim targets should be aligned with emissions pathways that are expected to limit temperature rises to 1.5°C above pre-industrial levels; the IPCC[4] has recommended a 50% global reduction in carbon dioxide emissions between 2010 and 2030.

For managers that have stated they will be targeting net zero for all assets under management, what are their plans for achieving this? **65%** of these managers said that they did not yet have a clear plan in place, and only **15%** have set an interim target for the proportion of assets to be managed in line with a net zero target.

> *We appreciate that it is a work in progress, but significantly more needs to be done to give investors confidence that net zero targets will be met by 2050 or earlier.*

Proportion of managers currently working towards net zero for assets under management



- No - we haven't yet considered this
- No - we've decided not to set such a target, at least for now
- Yes - for some strategies, but not all assets under management
- Yes - for all assets under management (subject to client and regulatory constraints), but we're still working out a plan to achieve it
- Yes - for all assets under management (subject to client and regulatory constraints), and we have a clear plan to achieve it

[4] Intergovernmental Panel on Climate Change

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Climate change – net zero

Managers expect to use a variety of tools to achieve net zero

There are multiple levers that managers can pull to achieve **net zero**, and we expect managers to utilise many of them. Managers and clients alike need to be mindful of seeking real-world reductions in **emissions**, rather than (just) focusing on reductions in portfolio emissions — only cuts in real-world emissions will reduce the systemic risks that investors face from climate change.

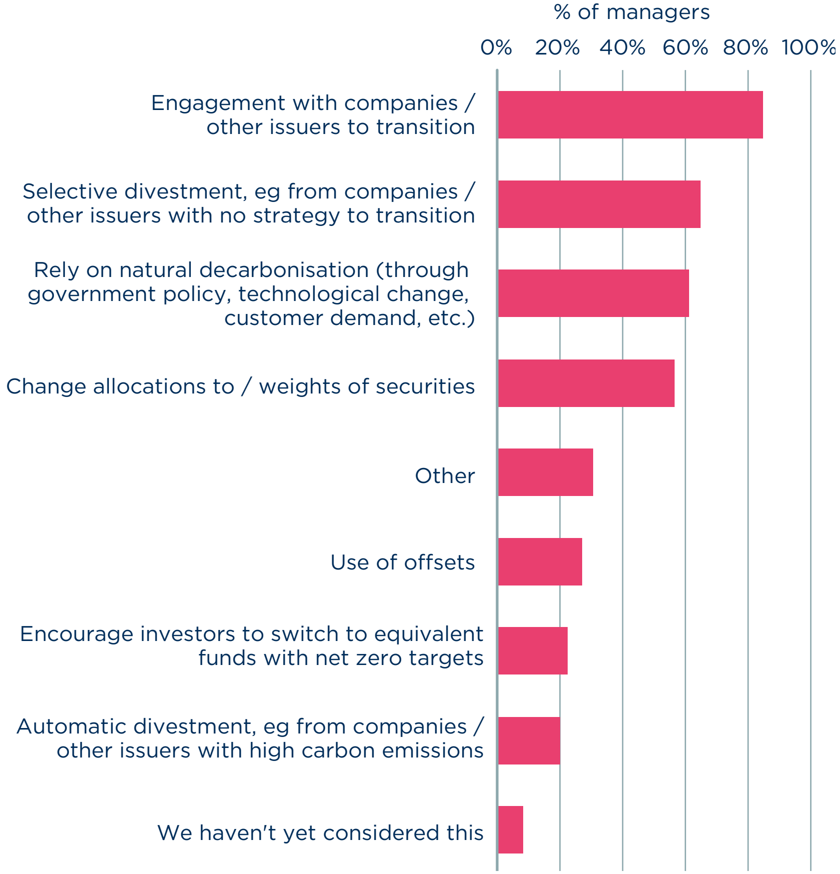
Positive action through **engagement** with companies and other issuers will have an important role to play in encouraging real-world reductions and was the most popular approach to decarbonise portfolios, chosen by **85%** of managers.

Another approach is to benefit from natural decarbonisation, whereby government legislation, improved technology and the actions of others will lead portfolios to naturally decarbonise over time. **61%** of managers say they intend to rely on this approach to some extent to achieve net zero and interim targets. Whilst we believe it is reasonable for managers to include this as part of their approach, we would expect managers to be taking active steps to reduce emissions as natural decarbonisation alone will not get us to net zero.

27% of managers say they will use **carbon offsets** in their portfolios. We expect carbon offsets to be increasingly reserved for limited circumstances: some of them may not be effective, and they may lead to a tendency to continue business as usual, with an unrealistic expectation that emissions can simply be offset. Signatories to the **Net Zero Asset Managers Initiative (NZAMI)** agree to limit the use of offsets only to those that involve long-term carbon removal and where there are no technologically and/or financially viable alternatives to eliminate emissions. It's worth noting that while many managers do not plan on using carbon offsets to achieve net zero at a portfolio level, they may be indirectly relying on the use of carbon offsetting through the underlying companies they invest in. We would expect managers to be undertaking engagement with these companies to reduce their reliance on offsets over time.

Many more managers **(76%)** already use or intend to use carbon offsets for offsetting emissions from their own operations. Some emissions may be unavoidable at this stage, but we would expect to see managers seeking real-world reductions in their own operational emissions as far as possible.

Tools or approaches managers expect to use to achieve net zero and corresponding interim targets



Jump to glossary

Reducing greenhouse gas emissions to net zero is crucial for the long-term best interests of our planet and with that the long-term best interests of investors and their beneficiaries. We are therefore delighted to have helped develop and launch the Net Zero Investment Consultants Initiative in 2021. As signatories to that initiative: we have integrated advice on net zero alignment into our investment consulting services; we will engage with investment managers; and we will collaborate with policy makers and the wider financial community to support efforts to decarbonise the global economy.

Ian Gamon
Partner

Stewardship – commitment

Most managers have increased their focus on stewardship

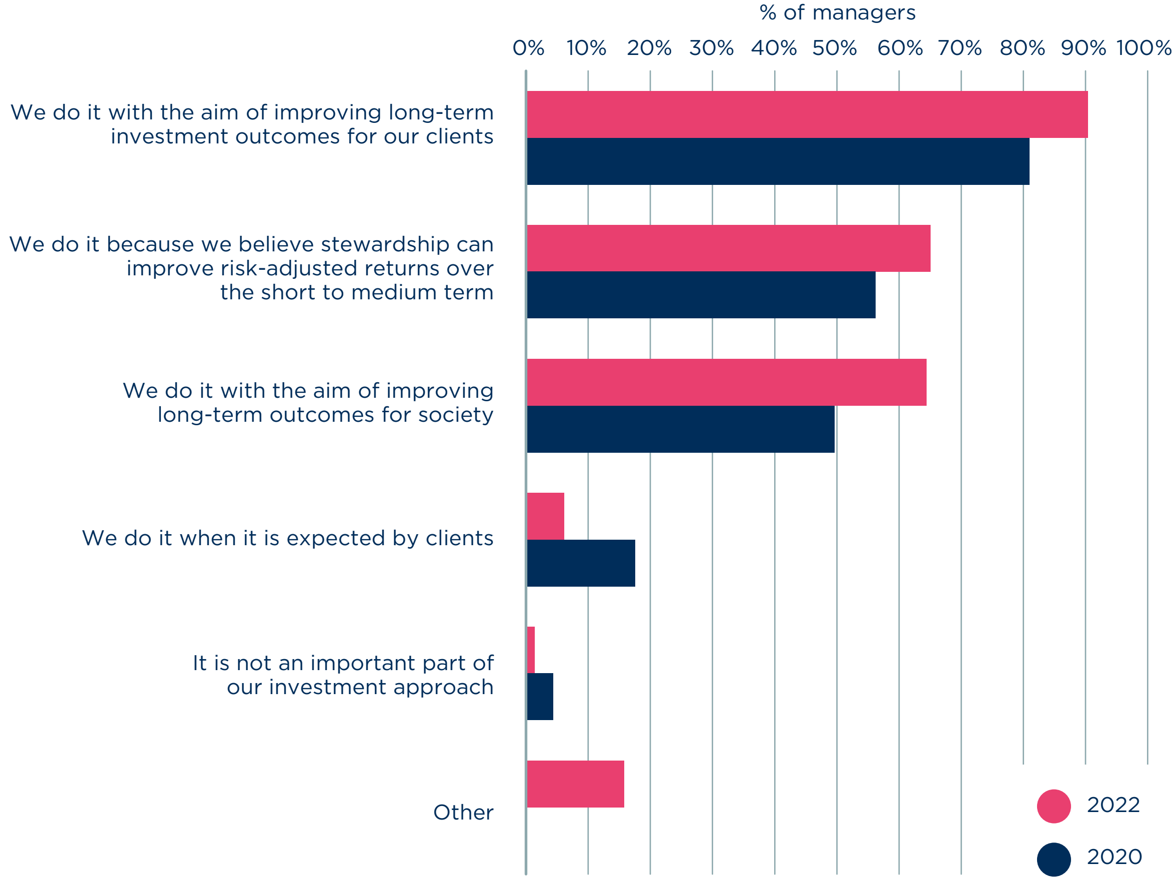
It is widely believed that good **stewardship** practices are vital for delivering superior financial performance for investors – laying the foundation for strong returns in five or ten years and beyond starts with good stewardship today.

In the **UK Stewardship Code 2020**, the Financial Reporting Council (FRC) defines stewardship as “the responsible allocation, management and oversight of capital to create long-term value for clients and beneficiaries leading to sustainable benefits for the economy, the environment and society.” It seems that managers broadly agree with this definition, with the majority citing improving long-term outcomes for clients (**90%** in 2022 vs **81%** in 2020) and society (**64%** in 2022 vs **50%** in 2020) as aims for their stewardship activities.

The UK Stewardship Code 2020 has significantly raised expectations compared to the 2012 Code. Its scope has been extended to cover all asset classes, not just listed equity and it has moved to annual outcomes-based reporting. Although it is a UK-based standard, if its predecessor is anything to go by, it will set the bar for other stewardship codes and increase expectations of stewardship practices in other regions.

The first wave of signatories to the UK Stewardship Code 2020 was announced in September 2021. In this wave, only **38%** of the managers we surveyed were confirmed to be signatories. This is lower than the proportion of managers in our 2020 survey who were signatories of the 2012 Code, despite the Code now being relevant to many more managers – this reflects the higher bar that the FRC has set. Managers that submitted a report but were unsuccessful in the first wave will have further opportunities to apply.

Managers' approaches to stewardship



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Stewardship – engagement

Climate change and human capital management are currently key engagement topics for managers

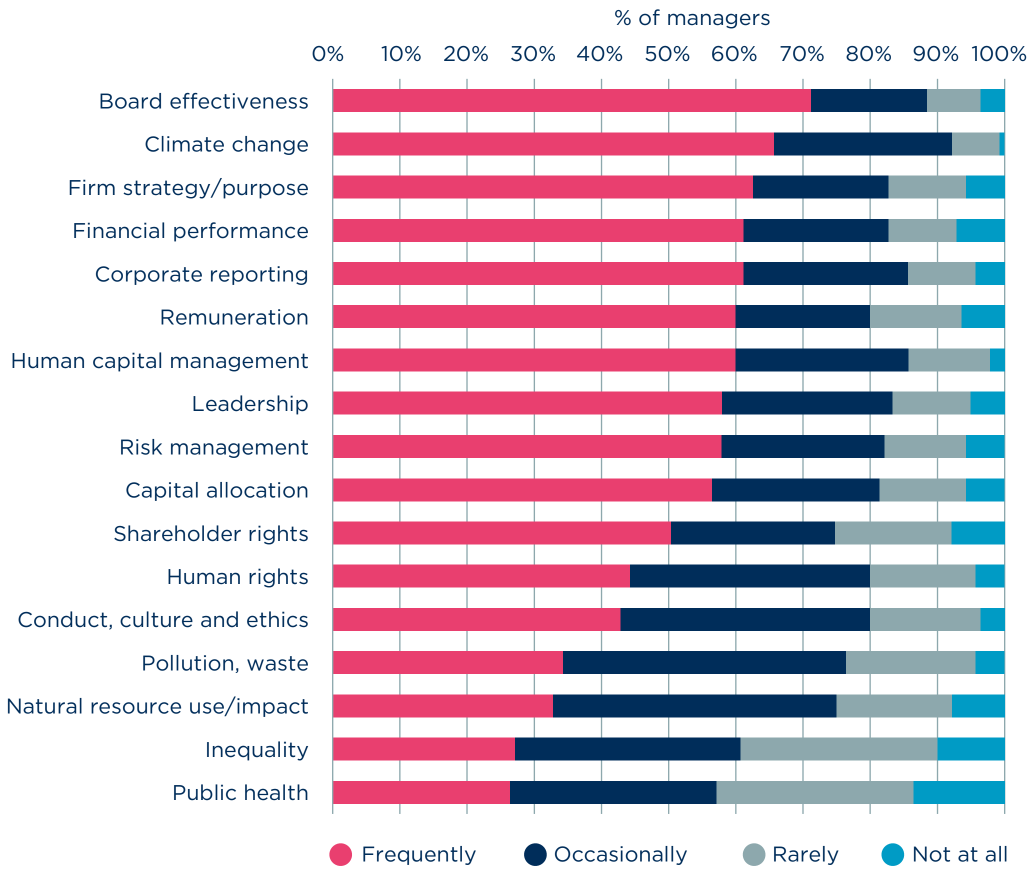
Engagement is purposeful, targeted communication with an entity (eg company, government, industry body, regulator) on particular matters of concern with the goal of encouraging change at an individual issuer and/or the goal of addressing a market-wide or systemic risk (such as climate change). We do not consider regular communication to gain information as part of ongoing research to count as engagement.

We surveyed managers about their engagement practices and found good evidence of engagement across a range of topics. Traditional topics of concern such as board effectiveness (**71%**), firm strategy or purpose (**63%**) and financial performance (**61%**) were frequently addressed with companies, issuers, governments, regulators or other stakeholders over the 12 months to 30 June 2021.

Climate change was a key engagement topic, as expected given the commitments we reported in the previous section. It is encouraging that managers are taking climate change seriously and seeking to drive change through their engagement efforts, although the proportion engaging frequently on climate change (**66%**) is notably less than the proportion who plan to use engagement to achieve their **net zero** targets (**85%**). It is also notable that environmental issues other than climate change, such as pollution, waste and water management, and biodiversity have been lower priority — only **a third** of managers frequently engaged on natural resource use/impact (eg water, biodiversity).

Many managers (around **60%**) also noted that human capital management was a key engagement topic for them. However, it is surprising that other social issues such as public health and inequality are at the bottom of priorities amongst the engagement topics we asked managers to consider in their response, with **43%** and **39%** of managers not engaging, or rarely engaging, on those topics respectively – this is particularly disappointing in light of the spotlight that has been shone on these topics during the Covid-19 pandemic.

Extent to which managers have engaged on different topics over the 12 months to 30 June 2021



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Stewardship – engagement

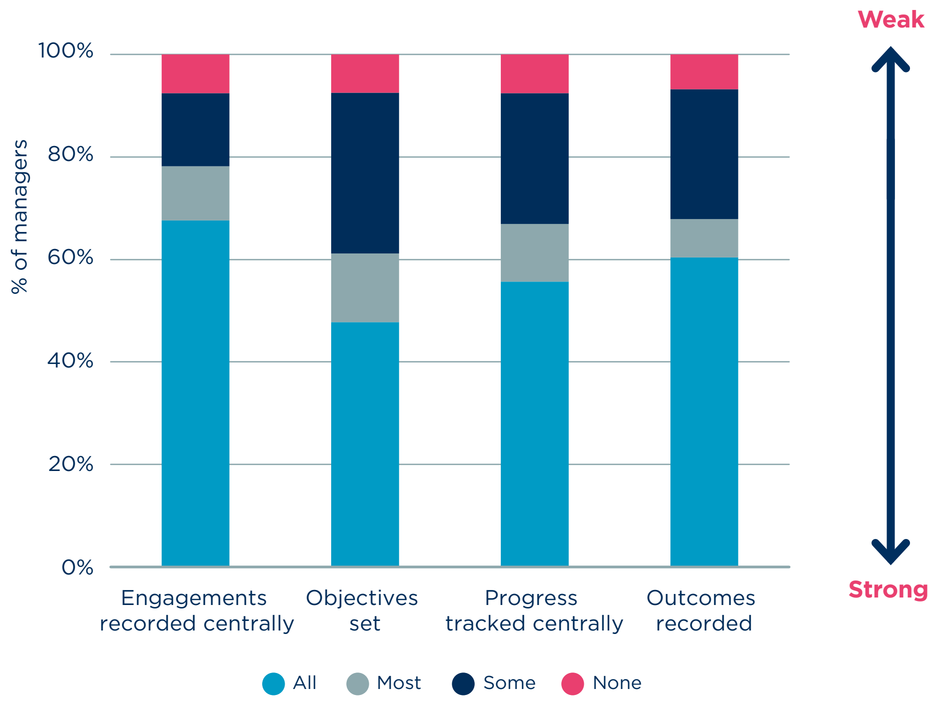
Most managers do not have a formal escalation policy to achieve their engagement objectives

There's a dilemma facing investors trying to encourage meaningful change. Should they remain invested, keeping their influence to drive change from within, or sell those holdings to make their views known? When investing in higher risk sectors and countries in particular, **engagement** can be a powerful driver of real world change, allocating capital to promote more responsible business practices (for example, a lower carbon business model or more robust supply chains). This approach also ensures that responsible investors aren't replaced by investors that would not prioritise these considerations in the same way.

Effective engagement requires clear objectives, consistent dialogue and regular monitoring against the objectives set. Most engagements by managers are being recorded centrally, with progress being tracked and outcomes recorded. However, managers are less good at setting objectives for their engagements, with less than half of managers setting objectives for all engagements.

Where engagement is not working effectively, escalation may be required. Escalation policies can be an important tool for managers to drive change where they have hit a roadblock in progress. It can involve various different forms such as writing a letter to the chair of the company, requesting a change to board membership, **voting** against re-election of board members or the threat of divestment. It is therefore disappointing that **42%** of managers do not have a formal escalation policy to help them achieve their engagement objectives. On the other hand, where managers do have a formal escalation policy, the majority of policies meet our best practice criteria of being publicly available, outlining steps taken in cases of unsuccessful engagements, providing timelines and/or triggers for escalation, and integrating into wider **stewardship** reporting.

Management of engagements by managers



Jump to glossary

Stewardship – engagement

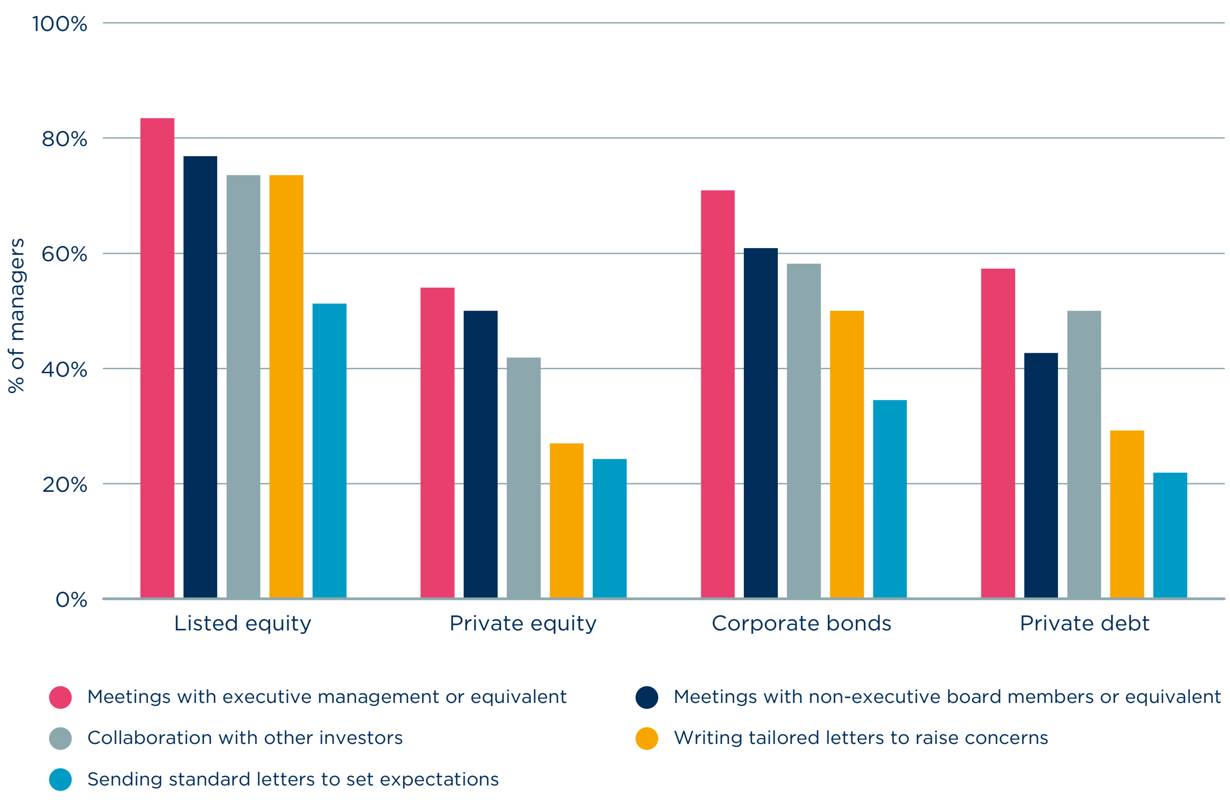
Engagement can be conducted in a variety of ways across different asset classes

Engagement, in all forms, whether meetings with management, tailored letters or collaboration, takes place more across listed equity than other asset classes. However, there is still a good range of activity for corporate bonds and private markets, albeit at lower levels.

Although the key type of engagement for all asset classes is meetings with executive management or equivalent, there is also a relatively high amount of engagement with non-executive board members and through collaboration with other investors. Collaboration can be an efficient and effective way for managers to pool their resources together to achieve collective aims. It also benefits the recipient by receiving one clear message from a group rather than multiple messages which can sometimes be conflicting. **28%** of managers stated they were leading on several high-profile collaborations, while only **5%** of managers don't collaborate with other investors, which is a big improvement compared to our 2020 survey.

Engagement can take place with a variety of stakeholders. **90%** of managers stated that they engage with policymakers or regulators on market- and/or industry-wide topics, which we view positively. This type of engagement can really help to move the dial with more widespread, systemic changes. For example, achieving **net zero emissions** will require actions by governments as well as companies, so it is important that investors signal their support for net zero to policymakers.

How managers typically conduct engagements by asset class



Jump to glossary

Stewardship – voting

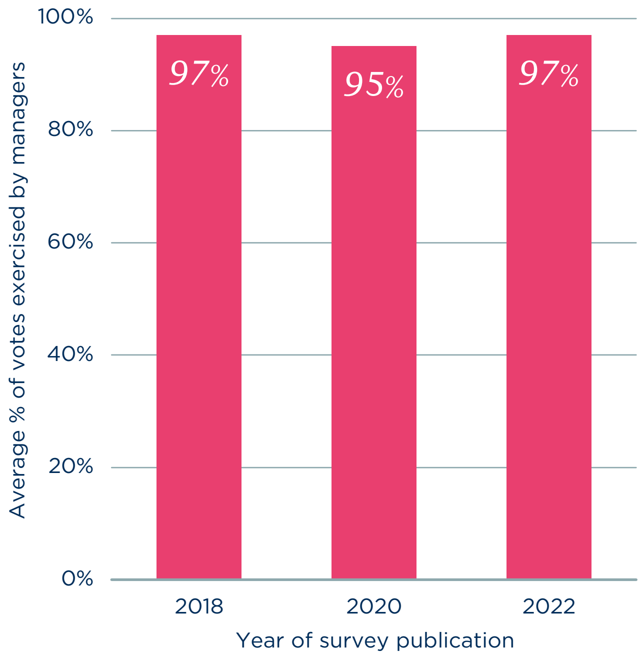
Managers continue to use their voting rights to influence…

Voting rights are an important way in which shareholders can hold company management to account and investors should expect managers to vote on their behalf wherever practical. It is an area that is becoming more prominent with the continued rise in shareholder activism, but how strong are managers' voting practices?

Listed equity managers continue to consistently exercise a high proportion of votes where they are eligible to do so, at an average of **97%** of votes across all managers we surveyed.

A high proportion of listed equity managers are willing to vote against management or abstain where appropriate (at least one vote at on average **35%** of AGMs during the same period, compared to **33%** in 2020 and **34%** in 2018). We view it positively that managers vote against management some of the time because it shows a willingness to express contrary views and adopt a considered position on the motion, rather than just voting with management (although this may be a decision delegated to a third party – more on that on the next page). However, there continues to be a wide variation, with the managers' individual answers ranging from less than 1% to 100% of AGMs.

Proportion of eligible votes exercised by listed equity managers



Implementation statement requirements

UK pension schemes are now required to produce annual implementation statements, in which trustees must disclose their voting behaviour. The Pensions and Lifetime Savings Association (PLSA) has created a template to help schemes with data collection from their managers so they can produce their implementation statements and appropriately scrutinise their managers' voting behaviour. Helpfully, **78%** of listed equity managers can already provide all required data in the PLSA template and an additional **20%** are working on their reporting capabilities in order to be able to do so. Only a small minority of managers have no plans to update their systems to be able to provide the required data. This greater voting transparency is useful for other asset owners too.

Jump to glossary

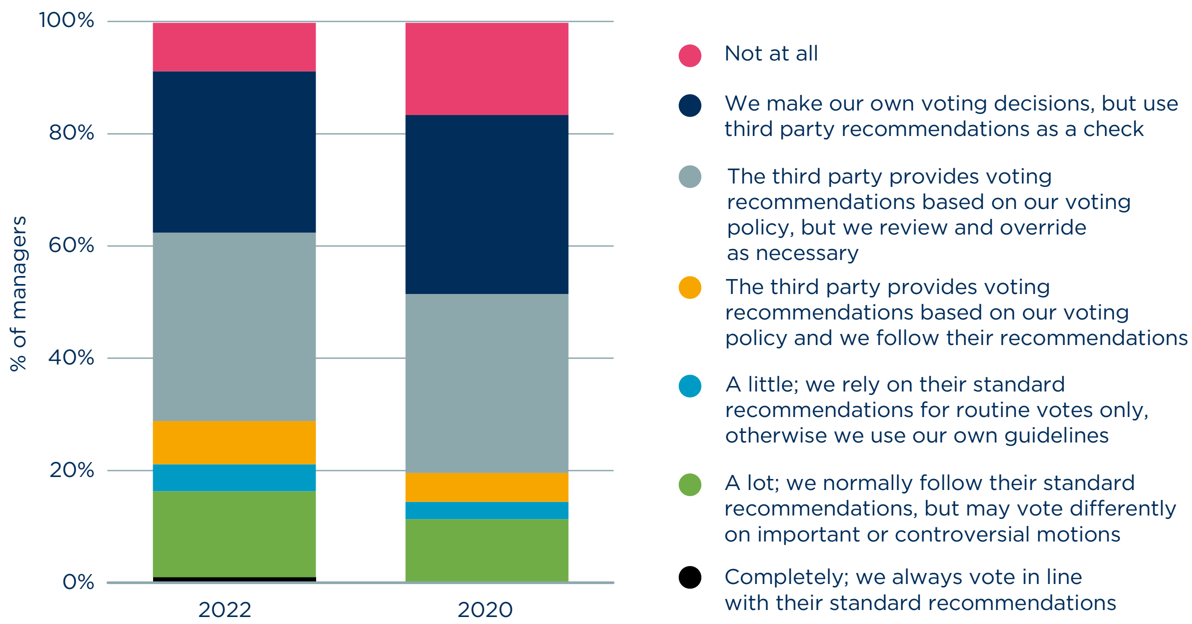
Stewardship – voting

...but rely slightly more on third party recommendations

We asked listed equity managers to what extent they rely on recommendations from proxy **voting** advisers when voting. Interestingly, despite the increasing focus on **stewardship** over the last two years, managers now seem to be relying more on third party voting recommendations. In our 2020 survey, only **14%** of listed equity managers relied completely or a lot on proxy voting advisors' recommendations, whilst in 2022, this number has risen to **16%**. This is a surprising step back by managers; we prefer them to apply their own views when voting, drawing upon their own knowledge of the companies.

Where clients invest in segregated mandates, many managers allow them to specify how their own votes are exercised. The same cannot be said for clients invested in pooled funds however. Out of the managers we surveyed, only **1%** said they can accommodate clients specifying their own voting instructions in pooled funds, with **92%** stating they don't and have no plans to introduce this option.

Extent to which listed equity managers rely on voting recommendations from third parties



Jump to glossary

We are proud to be in the first wave of signatories to the UK Stewardship Code 2020. In our 2020 stewardship report, we highlighted how we support our clients in this increasingly important area. We set high stewardship standards, both for ourselves and also for investment managers, encouraging them to continually up their game at each stage of the investment process. We also actively participate in external groups and work with other organisations, recognising that collaboration offers an opportunity for influence aimed at enhancing investment performance over the long term.

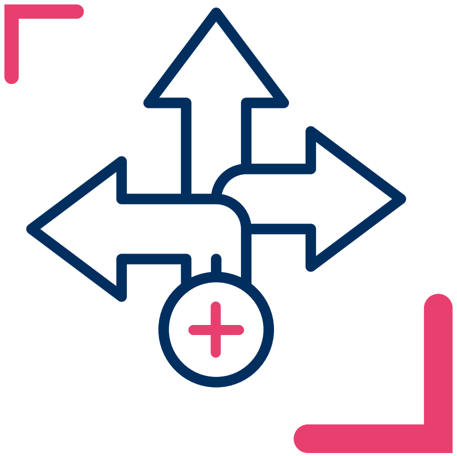
Paul Gibney
Partner

Conclusions

Actions for asset owners

Significant progress has been made by managers on RI since our 2020 survey and we are expecting even more progress over the coming years. However, asset owners cannot simply sit back and wait for progress to be made on their behalf. With the help of their advisers, they should continue to demand more of their investment managers in areas that are being neglected and make sure that managers are aware of their responsible investment expectations and beliefs.

It can be difficult for asset owners to know where they should be focusing their attention, so, based on the findings in this report, here are some key actions we think asset owners can take away when engaging with managers:



ESG integration

- Question how board oversight of the manager's responsible investment approach is implemented and what RI expertise exists at board level.
- Discuss with your managers the ways in which they use third party data for assessing ESG criteria in their portfolios, how they ensure the data is fit for purpose, and how the data influences investment decisions.

Climate change

- Engage with your managers to understand whether they have firm-level or portfolio-level net zero targets, and what interim targets and plans they have put in place or are planning to make to achieve the net zero goals.
- Encourage your managers to engage with all investee entities (not just equities) on the importance of setting net zero targets.
- Ask your managers about the extent to which climate scenario analysis is used to manage your portfolio and how they are using the results.
- Find out what climate-related metrics your managers can provide for your portfolios and encourage them to engage with investee entities to increase coverage of these metrics over time.

Stewardship

- For managers based in the UK or with significant UK-based investor assets, check if they are a signatory to the UK Stewardship Code 2020. If not, ask why not and encourage them to sign. For non-UK managers, are they signed up to other relevant stewardship codes?
- Ask your managers how they are considering social and wider environmental risks (not just climate change) for your investments and how they are engaging with investee companies on these topics.
- Do your managers have a plan in place for when engagement doesn't achieve their intended objective?
- Ask your managers to what extent they rely on proxy voting advisors when casting votes, and what criteria they use to determine when they should apply their own view where this differs from the advisor.

Glossary

Carbon offsetting — The process of paying someone else to avoid emitting, or to remove from the atmosphere, a specified quantity of greenhouse gases, for example through planting trees or installing wind turbines. It is sometimes used to meet net zero and other emission reduction targets.

Climate transition risks and opportunities — Transition risks and opportunities arise from actions and technological advances that are part of the transition to a low carbon economy in an effort to limit climate change, for example government legislation and shifts in consumer tastes.

Engagement — Dialogue between investors and relevant parties with the aim of preserving and enhancing the long-term value of assets on behalf of clients and beneficiaries. Relevant parties include companies in which the investor holds equity or debt, regulators, policymakers and other stakeholders.

Environmental, social and governance (ESG) — An umbrella term that encompasses a wide range of factors that may have been overlooked in traditional investment approaches.

- Environmental factors are issues relating to the quality and functioning of the natural environment and natural systems.
- Social factors are issues relating to the rights, well-being and interests of people and communities.
- Governance factors are issues relating to the way companies and other investee entities are directed and controlled.

Greenhouse Gas ("GHG") emissions — Emissions of gases that trap radiation from the sun which subsequently heats the planet's surface (giving rise to the "greenhouse effect"). The seven GHG for which countries are required to report emissions under the United Nations Framework Convention on Climate Change (UNFCCC) are carbon dioxide, methane, nitrous oxide, hydrofluorocarbons, perfluorocarbons, sulphur hexafluoride and nitrogen trifluoride.

Net zero — This describes the situation in which total greenhouse gas emissions released into the atmosphere are equal to those removed. This can be considered at different levels, eg company, investor, country or global. For example, the UK has committed to become a net zero country by 2050.

Net Zero Asset Managers Initiative — an international group of asset managers committed to supporting the goal of net zero GHG emissions by 2050 or sooner, in line with global efforts to limit warming to 1.5°C. It was launched in December 2020 and had 220 signatories with assets under management totalling $57 trillion by November 2021. Signatories make a series of commitments consistent with an ambition to reach net zero emissions by 2050 or sooner across all assets under management.

Paris Agreement — The Paris Agreement is an international agreement, adopted by nearly 200 countries at the UN climate conference in Paris in December 2015, which sets out a global framework to limit global warming to well below 2°C above pre-industrial times while pursuing efforts to limit it to 1.5°C.

Glossary

Physical climate risks and opportunities — Physical risks and opportunities arise directly from the changing climate, for example damage to buildings related to extreme weather events or the impact on crop yields of changing temperatures and rainfall patterns.

Principles for Responsible Investment (PRI) — A United Nations-supported initiative that encourages and supports responsible investment. Investors can publicly demonstrate their commitment to RI by signing up to six principles for incorporating ESG issues into their investment practices.

Responsible investment (RI) — The process by which ESG issues are incorporated into the investment analysis and decision-making process, and into the oversight of investments through stewardship activities. It is generally motivated by financial considerations and aims to improve risk-adjusted returns.

Scope 1 — Direct GHG emissions that occur from sources owned or controlled by the reporting entity, eg emissions from combustion of fossil fuels in owned or controlled boilers, furnaces, vehicles, etc.

Scope 2 — Indirect GHG emissions from the generation of purchased or acquired electricity, steam, heating or cooling consumed by the reporting entity. Scope 2 emissions physically occur at the facility where the electricity, steam, heating, or cooling is generated.

Scope 3 — All other indirect GHG emissions (not included in Scope 2) that occur in the value chain of the reporting entity. Scope 3 can be broken down into upstream emissions that occur in the supply chain (for example, from production or extraction of purchased materials) and downstream emissions that occur as a consequence of using the entity's products or services.

Stewardship — This is defined in the UK Stewardship Code 2020 as "the responsible allocation, management and oversight of capital to create long-term value for clients and beneficiaries leading to sustainable benefits for the economy, the environment and society". The term is sometimes used in a narrower sense, focusing on monitoring, engagement and voting in relation to investments, with the aim of preserving and enhancing their value.

Task Force on Climate-related Financial Disclosures (TCFD) — The TCFD was set up by the international Financial Stability Board in 2015 and its members are senior preparers and users of financial disclosures from across the G20, covering a broad range of economic sectors and financial markets. It has developed a set of recommendations for consistent climate-related financial risk disclosures, for use by companies and financial institutions of all types.

UK Stewardship Code 2020 — The UK Stewardship Code 2020 (the Code) sets high stewardship standards for asset owners and asset managers, and for service providers that support them. The Code comprises a set of 'apply and explain' principles for asset managers and asset owners, and a separate set of principles for service providers, accompanied by reporting expectations.

Voting — The exercise of voting rights on management and/or shareholder resolutions to formally express approval (or disapproval) on matters relevant to the governance of the company in question. In practice, this includes taking responsibility for the way votes are cast on topics that management raises, as well as submitting resolutions as a shareholder for other shareholders to vote on (in jurisdictions where this is possible).

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