Association of Member Nominated Trustees

AMNT review into fund managers' voting policies and practices

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1 Executive Summary

New regulations, wholeheartedly supported by AMNT, require pension schemes to take stewardship of their assets to a whole new level. They will require trustees to produce a Statement of Investment Principles (SIP) by October 2019 which sets out how they take account of financially material environmental, social and governance issues (ESG), including climate change, as well as their policies in relation to the stewardship of their investments including engagement with investee firms and the exercise of voting rights associated with the investment. They will no longer be able to simply state in their SIP that "we have delegated stewardship to our fund managers". They must demonstrate that they are actively holding their fund manager to account for their stewardship approach, during the selection, appointment and ongoing monitoring processes.

AMNT has worked hard to assist trustees to improve their stewardship. Having been unable to find a publicly available voting policy that comprehensively covered the range of ESG issues, AMNT spent two years consulting not only with trustees but also with many major players in the financial services industry, and at the end of 2015 AMNT launched its Red Line Voting policy.

The Red Lines were designed to assist trustees in developing their own voting policy, but also to make it easier for the fund management industry to respond to trustee ESG policies. If many trustee boards adopted these policies then the fund managers would be able to operate one collective policy for all those clients, limiting investment manager burdens. Pension schemes are of course free to develop and agree their own voting policies, but it was the absence of guidance in doing so for many pension schemes that led AMNT to take this action.

The Red Line policies did not dispense with the need for fund managers to use their expertise and judgement - far from it. AMNT made clear our expectation that fund managers should engage with companies as per usual but on the basis of the Red Lines, and then use their judgement to decide whether the company's performance in this regard merited the prescribed voting action. The fund managers are at liberty to vote contrary to the Red Lines if they judged that course of action to be in the clients' best interests, and if they did they were required to explain their reasoning to their clients.

However, as pension schemes began adopting the policies and asking their fund managers to implement them, they were astonished that their fund managers refused to accept them particularly with regard to holdings in pooled funds.

The majority of pension schemes have investments in pooled funds, and pooled funds represent almost half the assets under management in the UK, so the refusal to accept trustees' voting policies even on a comply or explain basis is a very serious matter.

This is putting trustees in an impossible position. The Pensions Regulator has stated that trustees must integrate ESG issues into their investment strategy if deemed financially material. The amendments to the Occupational Pension Schemes (Investment) Regulations create the new requirements set out above. The Shareholder Rights Directive states: ... "institutional investors and asset managers should publicly disclose information about the implementation of their engagement policy and in particular how they have exercised their

voting rights”. The Financial Reporting Council is updating its Stewardship Code with a view to holding trustees and others to greater account for their stewardship. The Business, Energy and Industrial Strategy (BEIS) Select Committee released a report on executive pay reform stating that "Ultimately, it is up to asset owners to give any direction on the stance to be taken by asset managers on corporate governance issues, including executive pay, and to hold them to account."

Faced with the regulatory and Parliamentary pressure on the one hand but the refusal of fund managers to enable trustees to fulfil these requirements and expectations on the other, AMNT raised these concerns. Trustees were told that they should leave stewardship to the fund managers as they have the resources and expertise to develop voting policies. They were also told that if clients do not like their fund manager's stewardship approach, they should take their business elsewhere.

This provoked several questions:

- How many fund managers are in fact prepared to accept their clients' voting policies and operate split voting on pooled funds?
- How did fund managers' voting policies compare to AMNT’s Red Line Voting policies, which cover ESG considerations and are derived in the main from the UN Global Compact and UK Corporate Governance Code?
- How publicly transparent were fund managers on their voting policies? Was there sufficient information in the public domain, presented sufficiently clearly, such that an asset owner, seeking to benchmark a fund manager’s voting policy against its own during the selection process, can conduct an effective comparative analysis?
- How much variation is there in voting policy across the fund management industry? Is there in fact any real consumer choice?

AMNT therefore conducted a survey of major fund managers to establish the answers to these questions.

The first action was to write to 35 fund managers in December 2017 asking them to state their policy on whether they would accept Red Line Voting, as an example of a trustee-owned voting policy, from their clients. Ten failed to respond. The others showed a near total unwillingness to split votes in pooled fund holdings. A wide variety of explanations appear in our report.

The second action was to take four of the AMNT's Red Line policies – on climate change, women on boards, ethnic diversity and executive pay – and to compare the extent to which the fund managers' public voting policies reflected these. For this comparison, we conducted a larger survey of 42 fund managers, including the aforementioned 35 fund managers. Public voting policies were accessed between February and May 2018, after which we reached out to the fund managers in the summer and autumn of 2018 to confirm our findings. We also confirmed whether any updated public voting policies were released after May 2018, and a separate section in this report summarizes those findings.

We note that our attempts to access what should be publicly accessible data were hampered by a range of problems which were disappointing and ought never to have presented themselves.

In addition, AMNT asked Manifest, predecessor of Minerva Analytics, to provide a sample of FTSE 100 companies that were in breach of the Red Line on excessive pay - the CEO paid more than 100 times the average pay of their workforces. We examined how 42 fund managers voted on the remuneration reports of the 28 companies identified by Minerva Analytics. Not all fund managers invested in every company.

We were unable to access 13 fund managers' voting records because they either did not disclose them publicly, were too difficult to access or only partially disclosed.

Assuming AMNT could gain access to the relevant section of the website, concerns were also noted with regards to the public disclosure of the voting policy and voting records themselves.

Findings

Climate change

Regarding climate change, we found:

- 4 out of 42 did not publicly disclose their voting policy
- 20 did not refer at all to climate change or 2 degrees
- 3 referred to climate change but had no voting guideline (which would set out how they may vote at the AGM) relating to that, plus no reference to 2 degrees at all
- 8 had a voting guideline of which 6 only have a guideline relating to shareholder resolutions, plus no reference to 2 degrees at all
- 2 referred to both climate change and 2 degrees, but had no voting guideline for either
- 1 had a voting guideline for climate change, but only a policy for 2 degrees
- 4 had voting policy and guidelines on both climate change and 2 degrees, but in some cases they were only for shareholder resolutions

It is of immense concern to AMNT that more than half of those that disclosed a voting policy did not have a climate change-related voting policy or guideline. It seriously calls into question the degree to which fund managers take these matters seriously or, at a minimum, execute these policies in as consistent manner as possible across companies. For those fund managers who do not even publicly disclose the voting policy itself and/or their voting records, asset owners are left with little to infer other than they lack strong commitment to the issue. We are, on the other hand, aware that a number of fund managers that failed to mention climate change in their voting policy do in fact take action on this matter and indeed some supported many shareholder resolutions on the matter. But it is difficult to understand why such an important issue should be held out of the voting policy and reported entirely separately.

This opacity and lack of comparability in the marketplace constitutes a market failure if asset owners are unable to select fund managers on clear and comprehensive policies, or hold them to account for their adherence to such policies as part of the monitoring process.

Gender diversity

Regarding women on boards, we found:

- 4 fund managers did not disclose their voting policy
- 12 fund managers did not reference gender diversity in their voting policy
- 16 fund managers referenced gender diversity but with no voting guideline
- 11 fund managers had a voting guideline regarding board diversity, however 6 of them either did not reference gender specifically when stating their voting guideline or if they did, it was only in reference to shareholder resolutions

Of those that publicly disclosed a voting policy more than 30% of fund managers made no reference to gender diversity on boards. It is not surprising, therefore, that the progress being made in getting more women onto company boards is so slow, since those who are holding for themselves the power to use shareholder votes appear to be choosing not to do so and failing to operate asset owner policies that would take this matter seriously.

Ethnic diversity

Regarding ethnic minorities on boards, we found:

- 4 did not disclose their voting policy
- 28 did not refer to ethnic diversity in their policy
- 6 referred to ethnic diversity but with no guideline
- 4 had a voting guideline but for either diversity in general or for supporting shareholder resolutions

Of those that publicly disclosed their voting policies, nearly 75% of fund managers made no specific mention of ethnicity with regard to board diversity and a little over 10% had any voting guideline on the issue. Given the Parker review and specific reference to ethnicity in the UK Corporate Governance Code since 2014, we are disappointed that the numbers of fund managers even mentioning it are so shockingly low. It is no surprise that ethnic diversity on FTSE 100 boards has declined[1] since there is almost no pressure from the fund management community to improve as many asset owners would wish. It is our view that this slowness of response to regulatory developments indicates a lack of investment belief on the materiality of the issue.

Executive pay

Regarding executive pay, we found:

- The use of ambiguous language such as companies should pay what is “necessary”, “reasonable” or “acceptable” or pay “should not be excessive”
- Linking of an executive's pay with other factors to determine what is deemed excessive, whether it be relative to peers, sectors, or most notably performance, which may do little to address the 'arms race' of CEO pay
- A few fund managers explicitly stated that excessive total remuneration was not a priority
- An over-reliance of the remuneration committee to resolve issues of excessive pay

[1] https://www.theguardian.com/business/2018/oct/12/top-firms-failing-to-increase-number-of-ethnic-minority-directors

- Based on our analysis, few fund managers (approximately 25% of those that published their policy) had a voting guideline on tackling excessive *total* remuneration in some form.

Regarding any policy linking executive pay to the workforce and specifically whether they referred to pay ratios, we found:

- 4 did not publicly disclose their voting policy
- 16 had no link between executive pay and the workforce at all
- 17 had a link with workforce pay but no voting guideline and only four specifically referenced pay ratios.
- 3 had a voting guideline which considered workforce in addition to other factors, of which only one referenced pay ratios
- 2 had a voting guideline which was specifically triggered by workforce pay, but none connected to pay ratios specifically

Regarding the fund manager voting records on remuneration reports as it relates to executive pay and workforce, we found:

- Five fund managers voted **against** the remuneration reports of only one of the 28 companies.
- Eight fund managers voted against two and a further eight voted against the remuneration reports of 3- 5 companies.
- Just one fund manager voted against more than they voted for (11 for and 14 against).
- 13 fund managers voted **in favour of** the remuneration reports of 20 or more of the companies, including one that voted for all but one of the 28 remuneration reports.
- Seven fund managers supported between 14 and 19.

AMNT believes that the use of ambiguous and seemingly boiler plate language, coupled with the small number of fund managers disclosing a voting guideline on this leaves asset owners with little information as to ascertain the degree of seriousness the fund manager takes the issue. Further, a significant number of fund managers appear to have discounted total remuneration as part of their assessment by either explicitly saying so, or indirectly by stating that their definition of excessive is relative most notably to peers and performance. The over-reliance on the role of the remuneration committee is also a notable concern. One fund manager stated that it is not their role as shareholders to weigh in on this issue, an attitude which is alarming because it begs the question: why is this not a priority for fund managers, when the issue may be important to the people whose money they are managing? And if it is not a priority for fund managers, and asset owners are prevented from intervening, then whose responsibility is it?

The UK Corporate Governance Code makes clear that the remuneration committee "should be sensitive to pay and employment conditions elsewhere in the group especially when determining annual salary increases." It is not in the shareholders' interests for companies to ignore this matter as doing so may cause a range of problems such as internal resentment, falls in productivity, industrial unrest, reputational damage, fall in output and fall in shareholder value.

Overall, it is extremely disappointing that the fund management community clearly does not share the degree of concern of AMNT, the government, FRC, workforces, trade unions, the media and the general public about excessive pay. We believe that they are failing to send the right signal to companies that excessive pay awards are inflammatory and damage confidence in both corporate governance and stewardship. What is worse is the large number of fund managers who will not accept asset owners' voting policies that could have led to a different voting outcome.

Conclusions

Given the regulatory pressure asset owners face with regard to the development of stewardship policies, AMNT was disappointed with the opposition received by the fund management sector to accept client voting policies in split voting arrangements.

AMNT does not doubt that accepting client voting policies in pooled funds presents a challenge to the fund management industry, however the response from most fund managers amounts to a failure to recognise and respond to the new regulatory environment to enable pension scheme trustees to fulfil their new responsibilities. AMNT finds it astonishing that well into the 21st century we are being told that the voting process is manual and this indicates to AMNT a lack of investment in the voting system. The Pensions Minister addressed this issue at the TUC Pensions Conference in February, in which he queried if the technology is the problem, why it cannot be fixed?

Operational and technological challenges should be addressed by a long overdue investment in the voting infrastructure system. If this is resolved, this will also solve a lot of the issues relating to cost, which we feel is an insufficient argument in any case given the fees paid to fund managers, and their profitability rates of 36%.

Our findings suggest to us that references by managers to lack of client demand in this context mainly reflect their success so far in suppressing it. Such excuses fail to recognise the increased regulatory requirements of trustees which will no doubt increase demand, and as a result, the need for fund managers to reshape their business models in order to accommodate them.

Based on our research, few fund managers had what AMNT considers best practice voting policies and guidelines on climate change, gender and ethnic diversity, at least that are publicly available. Fewer than 10% (on average) of fund managers were as robust and publicly transparent as the Red Line voting template. AMNT has been told that trustees should delegate all stewardship matters to fund managers as they have the superior expertise. But our review discredits this in demonstrating how far behind too many fund managers appear to be with regard to AMNT' view of best practice.

Our review demonstrates beyond doubt that there is no real market in voting policy due to insufficient transparency. Too many fund managers' public policies are, in the areas studied, out of alignment with either best practice or asset owners' and societal concerns. A significant number of fund managers are not prepared to publicly state either what their voting policy and/or guideline is. We believe the amount of flexibility being used as an excuse for the lack of

transparency is not serving clients' best interests especially in this regulatory environment, and indeed only serves to create doubt as to how serious the fund managers take the issues.

Some fund managers are prepared to provide public reporting after the fact as to what stewardship activities they have undertaken in these areas; however, without the corresponding voting policy or guideline, it is not full transparency and accountability in our view. And whether they state their voting policy and guidelines or not, too many fail to make their voting records easily accessible. This, coupled with those fund managers that only provide public firm-level (versus mandate specific) reporting to their clients, means that even if trustees attempt to exercise consumer choice and compare fund managers' voting guidelines and records against their own policies, this is not a viable proposition.

AMNT has been told that if trustees do not like the policies pursued by their fund managers they can take their business elsewhere. Our review indicates that there is nowhere else to go.

Recommendations

AMNT asserts that it is time that the FCA imposed minimum standards that trustees can expect from fund managers on stewardship, as similarly proposed by Professor Kay in his 2012 review. Based on the findings of this review, we believe that the minimum standards with regard to voting policies should at least include:

- Provision for acceptance of client voting policies to allow them to fulfil their regulatory obligations including within pooled funds
- Public disclosure of all voting policies and guidelines
- Public disclosure of their voting records in a manner that is easy for asset owners to interpret and also accessible
- Increased transparency and accountability with regard to the content of their voting policies in one place.
- Improved comprehensive (rather than case study-based) stewardship reporting at client/mandate and firm level

We believe that the lack of minimum standards has contributed to continued chronic under-investment in stewardship over a sustained period. Our review shows that such investment is long overdue and, although modest costs will be incurred, changes have to be made to enable pension scheme trustees to meet the letter and spirit of the new investment regulations and the existing expectations of the Pensions Regulator. This includes the right to direct their own voting policies in pooled funds.

We are therefore requesting that the FCA take urgent steps to investigate this market failure and propose remedies that will enable pension scheme trustees to develop their own stewardship policies and their fund managers to accept them including within pooled funds and operate them on a comply or explain basis.

2 Introduction

The Association of Member Nominated Trustees (AMNT) was established in 2010 as an organisation run by and for member-nominated trustees, directors and representatives of private sector and public sector pension schemes. We now have approximately 575 members from over 400 pension schemes that have collective assets of more than £775-billion.

It is clear that trustees are under greater pressure than ever before from a regulatory perspective to ensure that they have robust stewardship policies. These are regulatory changes that AMNT wholeheartedly supports. A key element of stewardship is the adoption of voting policies with regards to the companies in which they invest and the active use of their shareholder votes at corporate AGMs.

Over the last five years AMNT has worked hard to assist its members with this. The association developed what we believe to be the UK's first comprehensive, free to use, voting policy encompassing the range of environmental, social and governance (ESG) issues and launched it for 2016. But as pension schemes adopted this voting policy and requested that their fund managers use it on a comply or explain basis, they were shocked that the major fund managers refused to accept it particularly in relation to investments in pooled funds.

The majority of pension schemes have investments in pooled funds which, according to the Investment Association represent almost half the assets under management in the UK[2]. Much of this is in equities.

The refusal of fund managers to accept client voting policies is a systemic barrier to effective stewardship. If government and UK regulators are expecting asset owners to raise their game with respect to the development of robust stewardship policies, and taking into account beneficiaries' views in their approach, it is impossible for them to achieve this regulatory requirement if they cannot implement their policies through their external managers.

The fund management industry has put forward several reasons as to why they cannot accept client policies in pooled fund arrangements. One key response is that fund managers have the resources and expertise to develop voting policies, and that the responsibility of their creation and execution should be left to them. However, given upcoming changes to the Investment Regulations[3] where asset owners need to better hold their fund managers to account for the quality of their stewardship approach, this answer of "leaving it up to them" is no longer acceptable.

A response from others has been that if clients do not like their fund manager's stewardship approach they should take their business elsewhere. This response is predicated on the assumption that there is sufficient content within the public voting policies of fund managers such that an asset owner, during a beauty parade for example, can make meaningful comparisons between them. It is also predicated on the idea that there is sufficient choice of

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[2] https://www.theinvestmentassociation.org/investment-industry-information/research-and-publications/ams-2018/

[3] The Occupational Pension Schemes (Investment) Regulations SI 2005/3378, as amended by SI 2018/988.

fund managers whose policies are diverse enough to find ones which are sufficiently well aligned with those of the asset owners.

The views of the fund management community provoked several questions:

- How many fund managers are in fact prepared to accept their clients' voting policies and operate split voting on pooled funds?
- How did fund managers' voting policies compare to AMNT's Red Line Voting policies[4], which cover ESG considerations and are derived in the main from the UN Global Compact[5] and UK Corporate Governance Code[6]?
- How publicly transparent were fund managers on their voting policies? Was there sufficient information in the public domain, presented sufficiently clearly, such that an asset owner, seeking to benchmark a fund manager's voting policy against its own during the selection process, can conduct an effective comparative analysis?
- How much variation is there in voting policy across the fund management industry? Is there in fact any real consumer choice?

In order to answer these important questions and given the new regulatory responsibilities being placed on asset owners, AMNT undertook a review into fund managers' public voting policies.

[4] www.redlinevoting.org
[3]https://www.unglobalcompact.org/
6 https://www.frc.org.uk/directors/corporate-governance-and-stewardship/uk-corporate-governance-code

3 UK REGULATORY CONTEXT

In order to understand the issues facing pension trustees with regard to the stewardship of their investments it is essential to view them in the context of the legislation and regulations to which they must now or shortly will have to adhere.

3.1 The Pensions Regulator

There is a regulatory push for trustees to actively consider the financial materiality of ESG (ESG) issues for their pension schemes. In March 2017 the Pensions Regulator (TPR) stated that trustees must integrate ESG issues into their investment strategy if deemed financially material[7].

3.2 Department for Work and Pensions

The Department for Work and Pensions (DWP) in September 2018 published amendments to the Occupational Pension Schemes (Investment) Regulations that will require trustees[8] to produce a Statement of Investment Principles (SIP) which sets out how they take account of financially material ESG issues, including climate change, as well as their policies in relation to the stewardship of their investments, including engagement with investee firms and the exercise of voting rights associated with the investment[9]. More specifically, under new regulations, trustees will no longer be able to simply state in their Statement of Investment Principles that "we have delegated stewardship responsibilities to our fund managers" but must demonstrate that they are actively holding their fund manager to account for their stewardship approach, during the selection, appointment and ongoing monitoring processes.

The SIP will now also need to include, amongst other things, "the extent (if at all) to which non-financial matters are taken into account in the selection, retention and realisation of investments", where non-financial matters are defined as "the views of the members and beneficiaries including (but not limited to) their ethical views and their views in relation to social and environmental impact and present and future quality of life of the members and beneficiaries of the trust scheme".

DC schemes will also be required to produce an annual implementation statement on how the SIP has been following throughout the year, which will include how members' views have been taken into account.

We welcome these changes. We also welcomed the Pensions Minister's remarks at the February 2019 TUC Pensions Conference in which he questioned why pension schemes do not have control over their shareholder votes when they invest in pooled funds[10].

[7] See discussion of financial and non-financial factors at https://www.thepensionsregulator.gov.uk/en/document-library/regulatory-guidance/db-investment

[8] By 1 October 2019

[9] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/739331/response-clarifying-and-strengthening-trustees-investment-duties.pdf

[10] https://www.gov.uk/government/speeches/investment-innovation-and-future-consolidation-for-occupational-dc-pension-schemes

> *When many schemes – especially defined contribution schemes – invest in equities, they invest alongside others in pooled funds. They get to choose the fund and with it the investment manager, but they don't get to choose how to vote at annual general meetings for the companies' shares they hold. Those votes are about precisely the things I mentioned earlier – how the firms are preparing for climate change, how they treat employees, how executives are paid. Why can't the end investors – the trustees, which might include trade union members – cast those votes?*
>
> *I find this a puzzling situation. I hear that technology is a problem, but if that's the case we should fix the technology. I hear that asset managers think it's better to speak with one voice. But I don't think it's impossible to communicate that your investors have a diversity of views. I hear that it might even be legally questionable, but if that's the case why are some investment managers letting some clients vote?*

3.3 EU Shareholder Rights Directive

The EU Shareholder Rights Directive[11] has also made new recommendations on transparency and accountability with regard to the fund management industry as follows:

"Institutional investors and asset managers are often not transparent about their investment strategies, their engagement policy"[12] ... "institutional investors and asset managers should publicly disclose information about the implementation of their engagement policy and in particular how they have exercised their voting rights"[13].

"Asset managers should give information to the institutional investor that is sufficient to allow the latter to assess whether and how the manager acts in the best long-term interests of the investor and whether the asset manager pursues a strategy that provides for efficient shareholder engagement ... that information is key to allowing the institutional investor to assess whether the asset manager carries out a medium to long-term analysis of the equity and the portfolio which is a key enabler of efficient shareholder engagement"[14].

3.4 Financial Reporting Council

The Financial Reporting Council (FRC) is also in the process of updating its Stewardship Code with a view to holding trustees, fund managers, and other investment actors to greater account for their stewardship approach. The FRC have proposed taking a best practice, principles-based approach similar to that of the UK Corporate Governance Code, where signatory fund managers, asset owners and other investment actors will need to demonstrate the degree to which they adhere to these principles, and clearly explain how they have done so. In its draft Stewardship Code published in January 2019, the FRC has also included as a disclosure requirement that fund managers state whether they accept client voting instructions as part of their pooled fund arrangements.

[11] https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32017L0828
[12] Recital 16
[13] Recital 18
[14] Recital 20

3.5 Business, energy and industrial strategy Committee

The Business, Energy and Industrial Strategy (BEIS) Select Committee has released their report on executive pay reform[15]. In their findings, the Committee states that "The role of asset managers, who handle the day to day investment decisions of their clients, is central to executive pay reform. We have concerns about how they fulfil their role under current arrangements". The Select Committee report highlights a potential conflict of interest within the fund management community regarding their own pay arrangements which may hinder their ability to hold companies to account for their own.

3.6 Financial Conduct Authority

We note the joint FCA/FRC discussion paper on building a regulatory framework for effective stewardship[16]. Along with the FRC, the FCA is seeking feedback on what constitutes effective stewardship. We also note the work being done on fiduciary duty and what constitutes "clients' best interests" under the FCA Handbook[17]. Given the current regulatory environment as previously described, we support the exploration into what constitutes "clients' best interests". We believe this exercise is critical, and should include the flexibility of allowing clients' voting policies to be implemented as part of their contractual arrangements.

3.7 Areas of concern

We have identified the following areas of concern arising from recent regulatory developments in the light of the current state of affairs in the industry:

3.7.1 Holding fund managers to account for their stewardship approach

As the DWP is now expecting trustees to take a more proactive role in this area, it is imperative that the publicly available stewardship policies of fund managers are sufficiently informative to allow trustees to make an informed decision about which fund manager to either select/appoint in the case of a new mandate, or how to evaluate their approach while under contract. If there is insufficient information available in the market to distinguish between one fund manager or another on a particular issue (e.g., how a fund manager will – as opposed to finding out after the fact - vote if a company does not meet its expectations regarding climate change), this represents an information asymmetry that reduces competition and ultimately results in market failure, with consequent impacts for corporate governance. This is therefore a transparency issue that requires further attention.

3.7.2 Development of trustee in-house policies on stewardship

Trustees need investment routes which allow them to meet these evolving obligations with respect to stewardship. AMNT's Red Line Voting initiative is one very practical way of enabling pension schemes to meet this requirement within pooled fund arrangements while making it as

[15] https://publications.parliament.uk/pa/cm201719/cmselect/cmbeis/2018/2018.pdf
[16] https://www.fca.org.uk/publications/discussion-papers/dp19-1-building-a-regulatory-framework-effective-stewardship
[17] Discussion Paper on a duty of care and potential alternative approaches DP18/5 - https://www.fca.org.uk/publication/discussion/dp-18-05.pdf

easy as possible for fund managers, and it has been met with serious obstacles by the industry. Given the homogeneity and opacity of fund manager policies explored in this report, if fund managers and advisers do not support trustee efforts to meet the new regulatory requirements, the pensions and financial services industry will not meet the expectations which society, through the Government, now has of it.

3.7.3 Member scrutiny and consideration of members’ views

It is clear that the UK government is looking to empower members (or “savers”, as Professor Kay refers to them) to hold their pension fund trustees to account for how they are managing their money on its behalf. Given that trustees will have to be more transparent on these issues, greater scrutiny may ensue, forcing trustees to defend their policies. This makes the inclusion of best practice elements on their policies much more pertinent than ever before, not least with regard to reputational risk. If trustees have adopted ESG stewardship policies but their fund managers have refused to implement them – which is the predicament that some pension schemes are currently in – they will no doubt be considering how they can take on board their members' views, where they wish to, if even their own views are being ignored.

4 THE RED LINE VOTING INITIATIVE

The AMNT supports the regulatory thrust that trustees should be adopting active stewardship policies covering environmental, social and corporate governance (ESG) matters and as a result, should be allowed to direct how their votes are cast at shareholder meetings of the companies in which they invest, at the very least on a comply-or-explain basis. This is in alignment with the DWP regarding the development of stewardship policies, as well as TPR requirements which require that trustees take into account ESG issues if they are deemed to be financially material (which would mean holding companies to account on ESG issues through their own stewardship policy).

Red Line Voting is the UK's first comprehensive template policy for investors covering the range of ESG issues for UK equities. It was developed over two years by AMNT with very substantial consultation with the fund management industry, proxy voting companies, market analysts, investment consultants and of course pension scheme trustees and executives, with the kind assistance of the UK Sustainable Investment and Finance Association. It was sparked by the 'shareholder spring' of 2012 when pension scheme trustees attempted to use their votes in the revolt against excessive executive pay. The trustees – of small to fairly large schemes – discovered that they were unable to do so: they were told that as they invested in pooled funds their votes were under the control of the fund managers.

AMNT considered this to be unacceptable and, since it was explained that this was so because there was no trustee demand to use their votes and in any case it was difficult to vote multiple voting policies, resolved to develop a voting policy for trustees that they could put forward.

AMNT was unable to find any publicly available, comprehensive and prescriptive voting policy that encompassed ESG matters. The then NAPF voting guidelines for example covered governance only. The Financial Reporting Council's UK Corporate Governance Code at the time also largely ignored social and environmental matters.

The Red Lines were designed to make it easier for the fund management industry to respond to trustee ESG policies. If many trustee boards adopted these policies then the fund managers would be able to operate one collective policy for all those clients, limiting investment manager burdens. Other groups would of course be free to develop and mutually agree their own voting policies. **The policies did not dispense with the need for fund managers to use their expertise and judgement - far from it**. AMNT made clear our expectation that fund managers should engage with companies as per usual but on the basis of the Red Lines, and then use their judgement to decide whether the company's performance in this regard merited the prescribed voting action. The fund managers are at liberty to vote contrary to the Red Lines if they judged that course of action to be in the clients' best interests, and if they did they were required to explain their reasoning to their clients.

So in summary, the AMNT's Red Lines operate on a comply or explain basis: they still require fund managers to use their expertise and judgement on the voting decision following engagement with investee companies, and they are expected to communicate their voting decisions to their clients.

Fund managers advised us to base our voting policy on the United Nations Global Compact, a set of 10 principles which encompass ESG, and has global endorsement. We followed their advice. The 10 Global Compact principles are not a menu of principles that can be adopted or discarded according to the tastes of an individual fund manager or market, they must be adopted as a whole. However, our research indicates that fund managers' policies do not always reflect all of the UN Global Compact principles.

For example, Principle 3 of the UN Global Compact states: "Businesses should uphold the freedom of association and the effective recognition of the right to collective bargaining." AMNT therefore developed its Red Line policy S8 to reflect this: "Vote against the re-election of the Chair of the main board if there is a failure to abide by the UN Global Compact standards on freedom of association, including the recognition of independent trade unions for the purpose of collective agreement." Despite this being an accurate reflection of a very clear Global Compact principle, this Red Line policy has nevertheless been argued by some to be controversial and the view has been expressed that it was very political in nature.

In conclusion, the Red Line voting policy remains a viable option for trustees and as part of its campaign, AMNT continues to encourage asset owners and fund managers to adopt it. However as previously stated, the majority of fund managers (with the exception of three small companies) are still refusing to accept Red Line voting policies. It is important to state that our stance is not that all asset owners should adopt Red Line voting policies, but rather if such a large asset owner initiative, driven by the pressure placed upon them to be more active stewards of the companies in which they invest, has failed to be supported by the fund managers who are supposed to act on their clients' behalf, what chance do other asset owners have in this new regulatory environment, as described in the previous section, to do the same?

5 AMNT RESEARCH

In undertaking this research AMNT wished to answer the following questions:

- How many fund managers are in fact prepared to accept their clients' voting policies in pooled funds?
- How did fund managers' public voting policies compare to AMNT's Red Line Voting policies, which cover ESG considerations and are derived in the main from the UN Global Compact and UK Corporate Governance Code?
- How publicly transparent were fund managers on their voting policies and practices? Was there sufficient information in the public domain, presented sufficiently clearly, such that an asset owner, seeking to benchmark a fund manager's voting policy against its own during the selection process, can conduct an effective comparative analysis?
- How much variation is there in voting policy across the fund management industry? Is there in fact any real consumer choice?

In order to answer these important questions and given the new regulatory responsibilities being placed on asset owners, AMNT decided to undertake a review into the public voting policies of 42 fund managers.

Taxonomy

There is much confusion surrounding taxonomy regarding stewardship. Based on an informal review, there appears to be no standardisation as to how voting policies and guidelines are defined. Therefore, for the purposes of this report, we define the terms below as follows:

A **voting policy** can be defined as a description of the expectation that the fund manager has for an investee company regarding the ESG issue in question. It may also explicitly include the investment belief that the fund manager has. An example of a good voting policy which includes the expectation and the investment belief is below:

> *We believe that shareholder interests are best represented by a diverse and independently minded board of directors. We expect at least one third of board members to be female by 2020.*

A **voting guideline** can be defined as a voting decision that a fund manager will or may take subject to, for example, engagement outcomes. Note that we consider it implicit that any fund manager that has a voting guideline will also have a voting policy even if the latter is not explicit in their voting policy. An example of a good voting guideline, which connects to the above example of a voting policy, is below:

> *Vote against the re-election of the chair of the nomination committee if there is no strategy in place to address any under-representation of women at board level and fewer than 25% of the company's board members are female.*

Total remuneration will be defined as the single total figure for each director's remuneration

required to be included in the remuneration report by paragraphs 4 and 5 of Part 3 of Schedule 8 to the Large and Medium-sized Companies and Groups (Accounts) Regulations 2008 (SI 2008/410, as amended by SI 2013/1981).[18]

Fund manager acceptance of client voting policies

AMNT resolved to obtain a formal response from fund managers about whether they were prepared to accept voting policies from their clients in pooled funds – which is crucial if pension schemes are to fully adhere to the new regulations. The association wrote to the fund managers (Table 1 below) in December 2017 asking them to state their policy on whether they would accept Red Line Voting, as an example of a trustee-owned voting policy, from their clients. AMNT made it clear in the letter that the Red Lines operate on a 'comply or explain' basis: "The fund manager may vote contrary to the Red Lines if they consider that to be in the client's best interests, but if they do they are required to explain why they did so". AMNT asked the fund managers whether they would allow asset owner clients to adopt Red Line Voting for relevant equity mandates as a matter of policy (ie not on an exceptions basis for select clients).

Table 1: Fund managers

Aegon	Allianz	Aviva	Axa
Baillie Gifford	Blackrock	BMO	BNP Paribas
Columbia Threadneedle	Deutsche Asset	Fidelity	First State
HSBC	Invesco	Investec	Janus Henderson
JP Morgan	Jupiter	Kempen	LGIM
Lions Trust	MFS	MN	Newton
Old Mutual	Pictet	RBC	River & Mercantile
Robeco	Royal London	Schroders	Standard Life Aberdeen
State Street	UBS	Vanguard	

During AMNT's review Standard Life merged with Aberdeen Asset Management.

5.1.1 Summary of Responses

Ten fund managers failed to respond to this request.

[18]*Schedule 8 describes total remuneration as the sum of the following:*
(a)the total amount of salary and fees paid to or receivable by the person in respect of qualifying services;
(b)the total amount of bonuses so paid or receivable;
(c)the total amount of sums paid by way of expenses allowance that are—
(i)chargeable to United Kingdom income tax (or would be if the person were an individual), and
(ii)paid to or receivable by the person in respect of qualifying services;
(d)the total amount of—
(i)any compensation for loss of office paid to or receivable by the person, and
(ii)any other payments paid to or receivable by the person in connection with the termination of qualifying services;
(e)the total estimated value of any benefits received by the person otherwise than in cash that—
(i)do not fall within any of paragraphs (a) to (d) or paragraphs 8 to 12,
(ii)are emoluments of the person, and
(iii)are received by the person in respect of qualifying services

The fund managers who did respond interpreted the Red Line Voting policy as requiring split voting on pooled funds – in other words, while the fund managers vote according to their 'house' policy for the overall fund, they would vote the proportion of votes allocated to the Red Line asset owner. We would consider this to be the ideal. However, since AMNT has made it explicit that the Red Lines operate on a comply or explain basis, a fund manager willing to try to accept client voting policies but who had difficulty with the mechanics of split voting might have considered use of 'comply or explain' and agreed to explain to the client why, on each occasion that they had not voted according to Red Line policies. However, none did.

Of those that responded, the only one to state that they had no problem with split voting was one that had no pooled funds. Two fund managers were willing to accept split voting for select clients on a case-by-case basis, though not for all clients. Another fund manager stated that their voting stance may be recommended but the client may choose to vote otherwise, but that this is facilitated on an ad-hoc basis as and when the asset owner makes a request, rather than through the application of a separate voting policy. Six fund managers merely stated that they could not offer split voting but gave no explanation.

Of the remaining fund managers, the reasons given for refusing to accept their clients' voting policy in pooled funds can be summarised as follows:

Operational risk and added costs

Most referred to operational complexities that make split fund voting difficult, impeding their ability to execute the votes in a timely manner. Manual risks (i.e. overriding the vote is done manually) were an issue: one fund manager noted: "We are also acutely aware that split voting would require a manual intervention which opens up the possibility for human error in providing instructions for a nominated proportion of fund units." With regard to broader technological considerations, one stated: "This is not something we are able to do consistently, with complete reliability for the underlying client and without endangering the voting rights of others within the pooled fund"

On costs, one suggested that split voting would have to be delivered by having a separate share class within a particular fund - and split voting clients would be charged more. Another suggested that the client's investment in the pooled fund would need to be put into a segregated mandate so that the client can retain their vote but have to pay for a proxy voting agency themselves. A few mentioned that they would only consider accepting client policies for segregated mandates.

Legal issues

One fund manager noted the legal considerations associated with who owns the voting rights within the pooled fund arrangement – the asset owner or the fund manager.

Insufficient client demand

Client demand was an issue: one said there was insufficient client demand for split voting and that It would be impractical to do this "unless we had a groundswell of client demand" and that they would only consider split voting if sufficient clients signed up to doing it. Another stated: "We know that the intent of the Red Lines is not necessarily that the relevant recommendations are followed, but that fund managers take a comply or explain approach.

this is unlikely to happen in practice, at least until a significant weight of money seeks Red Line Voting: the administrative and cost burden of a parallel analysis and reporting process would mean that we would for economic reasons choose to comply rather than explain."

Refusal as a matter of principle

Finally, several fund managers simply refused to accept client instructions on Red Line voting as a matter of principle. One stated: "We have taken the very strong view that [the fund manager votes] with one voice … we do not split votes out by fund manager and we do not vote client accounts differently than we vote our own. There is a very good reason for this; it provides clarity of message and brand on high profile issues like corporate governance and executive pay. Splitting of votes runs the risk of diluting this message."

Another used the argument of consistency: "By voting the same way for all our clients, our votes will have much more of an impact on the meeting outcome (on resolutions being passed or defeated), particularly as often we have large, conviction holdings. We can point to numerous occasions where our voting has held management to account and resulted in improvements to company practice".

More broadly, one fund manager summed up their concerns as follows: "Split voting might not be in the client's best long-term interests. For many clients there are advantages in investing in pooled fund structures - economies of scale and cost sharing for the portfolios' investment and stewardship activities. We also believe that splitting votes within a pooled fund will send conflicting signals to investee companies and potentially undermine the credibility and opportunity of success for any specific engagement. As our clients in pooled funds effectively delegate the execution of this stewardship policy to us, it is important to ensure that we do not undermine the potential for successful engagement by providing management with conflicting signals."

However, two fund managers stated that they would be willing to engage with key stakeholders, including the Investment Association, to find an industry solution to this issue. One indicated that they had referred the matter to the Investment Association in March 2018, and another made reference to the Investment Association in a similar manner.

5.1.2 Conclusion

AMNT does not doubt that accepting client voting policies in pooled funds presents a major challenge to the fund management industry, however the response from most fund managers amounts to a failure to recognise and respond to the new regulatory environment to enable pension scheme trustees to fulfil their new responsibilities. AMNT finds it astonishing that well into the 21st century we are being told that the voting process is manual and this indicates to AMNT a lack of investment in the voting system, particularly as fund managers have to split pooled fund investors' holdings for the purposes of distributing income, differential charging and so on. Even the Pensions Minister addressed this issue at the recent TUC Pensions Conference in February, in which he queried if the technology is the problem, why it cannot be fixed?

Concerns from the fund managers regarding client demand represents, in our view, a convenient excuse for inaction. It also fails to recognise the increased regulatory requirements of trustees which will no doubt increase demand, and as a result, the need for fund managers

to reshape their business models in order to accommodate them. It has also created a vicious circle. Fund managers have criticised the lack of engagement from trustees in the area of stewardship, but when trustees act in accordance with TPR expectations and put forward voting policies these are refused and then because the fund managers have refused, trustees are advised that it is not possible.

The rejection of client voting policies on principle indicates substantial opposition within the fund management industry to trustees' attempts to take their stewardship responsibilities seriously with their pooled fund investments. To state that in a pooled fund arrangement, the voting policy is "delegated to the fund manager", stands as a direct obstacle to an asset owner's regulatory obligation to set its own stewardship policy. More specifically, it also does not align with recent DWP regulatory changes to the SIP, in which it is no longer acceptable that asset owners simply "delegate" stewardship responsibilities to their fund manager, with "delegate" in this context meaning no robust oversight or monitoring. This is also of particular concern to DC schemes who have greater pressure to consider members' views in the formulation of their own stewardship policies. More broadly, these arguments "on principle" fail to recognise one simple fact: that it is not the fund managers' money that they are managing, rather the asset owners' money.

The fund manager's insistence on sending one very strong message on an issue to the investee company was also recently rebutted by the Pensions Minister at the abovementioned TUC conference in which he queried why there was an issue in communicating to an investee company a diversity of views.

The comments regarding asset owners having to pay to execute the policy themselves begs the question as to why we pay such generous fees to fund managers – with average profit margins of 36% [19] –if they cannot absorb the relatively small cost of executing a bespoke client policy.

Overall, the fact that 44% of the £7.7-trillion of assets under management in the UK are in pooled funds[20], shows what a major issue this is. But the overall response appears to have similarities with the debate over fee transparency which dragged on until FCA intervention to establish an independent review panel. We believe that the expression by some fund managers of a willingness to engage with others in the industry on this issue reflects an admission that there is a problem which we believe requires regulatory intervention.

5.2 Public Disclosure of Voting Policy and Voting Records

Our attempts to access what should be publicly accessible data were, in the first instance, hampered by a range of problems, which can be summarised as follows:

- Fund managers failing to publicly disclose the information at all;
- Fund managers only disclosing the information to clients on request;
- Websites that banned trustees or the public from accessing them;

[19] FCA Asset Management Market Study: Final Report (MS 15/2.3) - https://www.fca.org.uk/publication/market-studies/ms15-2-3.pdf. Profit margin of 36% is not just pooled funds. More details on profit calculation can be found here: https://www.fca.org.uk/publication/market-studies/ms15-2-3-annex-1.pdf

[20] See footnote 2- Investment Association report

- Websites that banned UK trustees but not those from other countries from accessing them (geo-blocking);
- Websites where we had been assured that the information was publicly accessible, but it was so difficult to find that fund managers had to send the link; and
- Information presented in a format that made it extremely difficult to access (e.g., 11,000 PDF).

Assuming AMNT could gain access to the relevant section of the website, concerns were also noted with regard to the public disclosure of the voting policy and voting records themselves. In relation to the voting policy, three fund managers either did not publicly disclose an in-house policy document or it was difficult to access, while one executes client voting polices and thus does not have an in-house policy to publish (for a total of 4 fund managers). For the summary of analysis of each issue of concern in bullet point form, the first bullet point represented these aforementioned four fund managers.

With regard to voting records, the following was noted:

- Six fund managers do not appear to publicly disclose their voting records at all;
- Three fund managers had voting records which were extremely difficult to access; Voting records of one fund manager were contained within an 11,000-page PDF, while the others disclosed their records by fund (either online or via PDF);
- Two fund managers only provided partial disclosure for the year studied (2017); and,
- Three fund managers did not have, or did not retain, voting records prior to 2018 through their online database

The 2012 FRC Stewardship Code requires institutional investors to publicly disclose their policy on how they will discharge their stewardship responsibilities and to publicly disclose their voting records. The 2019 draft Stewardship Code further states that the voting records should be accessible and easy to interpret. Given current and upcoming soft regulation in this area, the above noted findings are significant and warrant further attention from the FCA and FRC.

5.3 Voting issues research approach

AMNT selected policies from each of the ESG policy pillars, each of which had a corresponding Red Line policy. These were then compared with the public voting policies of 42 fund managers (Table 2 below) to see how many fund managers had similar policies and, in the case of excessive pay, whether these policies had translated into votes at company AGMs. Voting policies were accessed from the relevant fund managers' websites during the period of February to May 2018. A cursory review of any updated policies between May and December 2018 was also conducted, the findings from which are presented in a separate section in this report.

The Red Line voting policies selected for comparison with fund manager voting policies and guidelines covered climate change and specifically how companies were working to limit global warming to two degrees; equality – women and ethnic minorities on boards; and excessive executive pay. We selected these on the basis of strong government support for them, public interest including among pension scheme members, and reference to these issues in the UK

Corporate Governance Code and/or legislation or guidance. Further explanation of our approach to each issue is explained below.

Table 2: Fund Manager Voting Policy Sample

Aberdeen	Aegon	Allianz GI	Aviva
Axa	Baillie Gifford	Blackrock	BMO
BNP Paribas	BNY Mellon	Columbia Threadneedle	Deutsche Asset Management
Fidelity	First State	Goldman Sachs	HSBC
Insight	Invesco	Investec	Janus Henderson
JP Morgan	Jupiter	Kames Capital	Kempen
LGIM	Lions Trust	M&G	MFS International
MN	Newton	Old Mutual	Pictet
Rathbones	RBC	River & Mercantile	Robeco
Royal London	Schroders	Standard Life	State Street
UBS	Vanguard		

During AMNT's review Standard Life merged with Aberdeen Asset Management.

Following the completion of our research, we wrote to each fund manager to inform them of our findings and to request their view as to its accuracy **as it pertained to their public policy document, not any internal voting policies and guidelines they may have on the issue of concern**. 37 fund managers chose to respond in some form, and a few put forward corrections with respect to the voting instructions which were accepted if they fell within our criteria as stated in our methodology. Of note, if the fund manager relayed more detail on their policies or guidelines which did not appear in the public voting policy itself, it was not given credit as one key objective of this review was to determine the **public** transparency and accountability of the fund management industry on their voting policies, given the regulatory requirements being placed on them in this area.

In order to compare "apples with apples", we broadly divided the voting policies on climate change, diversity, and total remuneration as it relates to the workforce as follows (going from worst to best practice):

- No public disclosure of the voting policy in its entirety on the website
- No public disclosure of either a voting policy or voting guideline within the policy on the issue in question
- Public disclosure of the fund manager's voting policy
- Public disclosure of the fund manager's voting guideline

Decisions made as to what constituted a voting policy or guideline unique to the specific ESG issue in question are provided in the relevant sections of this report. We also felt it was important to differentiate between those fund managers whose voting policy or guideline for the issue of concern was **only for shareholder resolutions** as opposed to being applied more broadly. Due to its diverse content, we have provided a qualitative discussion of how the fund managers' voting policies and guidelines regarding total remuneration in general were disclosed.

5.4 Policy issue: Climate Change

Climate change risks are huge long-term risks facing investors. The UK policy signal is clear – the transition to a low-carbon economy is inevitable and, predating the Paris Agreement on climate change in 2015, the UK passed the Climate Change Act in 2008. It is imperative that fund managers develop and implement robust voting policies on climate change, in order to send a clear and strong signal to companies that they need to transition their business models to a 2 degree scenario.

5.4.1 Red Line policy: Climate Change

The Red Line Voting policy on climate change is as follows:

- **Year one: If the company has failed to introduce and disclose emission reduction targets vote against the re-election of the chair of the Environmental Sustainability Committee (or equivalent).**
- **Year two: If the company has failed to commit to introducing and disclose science-based emission reduction targets with a coherent strategy and action plan in line with a 2 degree scenario vote against the re-election of the chair of the Environmental Sustainability Committee (or equivalent).**
- **Year three: if the company has failed to introduce and disclose the above, vote against the re-election of the chair of the Environmental Sustainability Committee (or equivalent).**

The Red Line refers to action being taken on climate change and specifically strategies that would help to limit global warming to 2 degrees. We therefore looked at whether the fund managers had a voting policy on climate change and if so whether there was a voting guideline. We then looked at whether the fund managers had a voting policy pertaining to a 2 degree scenario and if so whether there was a corresponding voting guideline. The following was also incorporated into our analysis:

- Those who mention environmental issues but made no specific reference to climate change were not credited with having a voting guideline. Environmental issues do not necessarily mean climate change; they could refer to polluting the area around a factory for example.
- Those who mention the Task Force on Climate Change Related Disclosures (TCFD) in their voting policy were credited with both climate change and 2 degrees as a voting policy.
- Those who mention support for the Carbon Disclosure Project (CDP) in their voting policy were also credited with both climate change and 2 degrees as a voting policy
- Those who mention the support for initiatives such as CERES or Global Compact which reference climate change and/or 2 degrees were given appropriate credit depending on how it was referenced
- Those who mentioned that they would address climate change issues on a "case by case" basis were not given appropriate credit as this is not a strong enough signal as to what they expect from companies on a voting policy basis, or how they may/will vote to register dissent.

5.4.2 Findings: Climate Change

4 out of 42 did not publicly disclose their voting policy

20 made no reference at all to climate change or 2 degrees in their voting policies or guidelines

3 had a voting policy on climate change but no voting guideline and no reference at all to 2 degrees

8 had a voting guideline of which 6 only had a guideline relating to shareholder resolutions, plus no reference to 2 degrees at all

2 had voting policies for both climate change and 2 degrees, but no voting guideline for each

1 had a voting policy and guideline for climate change, but only a policy for 2 degrees

4 had voting policies and guidelines for both climate change and 2 degrees, but in some cases they were only for shareholder resolutions

Of those that publicly disclosed a voting policy (38), over half of the fund managers did not have a climate change-related voting policy or guideline in their voting policy. This is of immense concern to AMNT and should be of huge public and government concern because it seriously calls into question the degree to which they take these matters seriously or at a minimum, execute these policies in as consistent manner as possible across companies. For those fund managers who do not even publicly disclose the voting policy itself and/or indeed their voting records, asset owners are left with little to infer other than they lack strong commitment to the issue. We are, on the other hand, aware that a number of fund managers that failed to mention climate change in their voting policy do in fact take action on this matter and indeed some supported many shareholder resolutions on the matter. But it is difficult to understand why such an important issue should be held out of the voting policy and reported entirely separately.

This opacity and lack of comparability in the marketplace constitutes a market failure if asset owners are unable to select fund managers on clear and comprehensive policies or hold them to account for their adherence to such policies as part of the monitoring process.

We also find it disheartening that very few fund managers had a voting guideline that was not dependent on shareholder resolutions with respect to climate change. The Red Lines are designed to enable the shareholder to use their votes on existing resolutions at an AGM, such as directors' elections. This would enable shareholders to register dissent at any company AGM. Shareholders are also at liberty to propose their own resolutions and some do but this is not a particularly widespread feature in UK corporate AGMs. Reliance on supporting shareholder resolutions rather than having voting guidelines applicable to any company's AGM therefore severely restricts the potential for registering dissent.

So for those lagging companies where shareholder resolutions on climate change were not proposed, the fund manager's policy would appear to have no mechanism with which to

address it. In our view, this lacks a consistent approach and strong signalling across companies which is necessary in order to seriously address the issue at a meaningful scale.

Further, very few made specific reference to 2 degree alignment and only one fund manager had a voting guideline on this that was not dependent on shareholder resolutions put forth by others. This finding is alarming given the globally accepted view of the long-term consequences to our investments and pension scheme beneficiaries, and ultimately the world itself, by failure to limit global warming to 2 degrees.

Overall, these findings are especially frustrating for asset owners because it shows that not only are the majority of the fund managers not demonstrating best practice in these areas, they are also refusing to accept the policies of their clients who wish to adopt good practice in this area such as by adopting Red Line Voting.

5.5 Policy Issue: Gender and Ethnic Diversity

Gender diversity is a central theme of UK government policy as well as being one of the UN Sustainable Development Goals[21], which the UK government has adopted. The Hampton-Alexander review set a target of women holding 33% of board positions on the FTSE 350 by 2020[22] and specific reference to gender diversity has been made in the FRC's UK Corporate Governance Code.[23]

On ethnic diversity, the Parker Review[24] set a target that each FTSE 100 Board should have at least one minority ethnic director by 2021; and each FTSE 250 Board should have at least one by 2024. It also stated that nomination committees of all FTSE 100 and FTSE 250 companies should require their internal human resources teams or search firms (as applicable) to identify and present qualified minority ethnic candidates to be considered for Board appointment when vacancies occur. The government has endorsed these aims, made many statements with regard to the need for ethnically diverse boards, and the FRC UK Corporate Governance Code has also made specific reference to ethnicity.

The under-representation of women and ethnic minorities on company boards suggests that to many, "diversity" on boards does not necessarily include gender or ethnic diversity: while the FRC states that diversity includes gender and race, it adds that "it is as much about differences of approach and experience". About 80 companies in the FTSE 350 were recently reported to have either just one female director or none at all[25] and the Parker review[26] stated that while 14% of the population identifies as BAME (Black, Asian and minority ethnic), only 1.5% of directors in FTSE100 boardrooms are UK citizens from a minority background. More

[21] https://www.gov.uk/government/publications/implementing-the-sustainable-development-goals/implementing-the-sustainable-development-goals
[22] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/613085/ftse-women-leaders-hampton-alexander-review.pdf
[23] https://www.frc.org.uk/getattachment/ca7e94c4-b9a9-49e2-a824-ad76a322873c/UK-Corporate-Governance-Code-April-2016.pdf
[24] https://www.gov.uk/government/publications/ethnic-diversity-of-uk-boards-the-parker-review

[25] https://www.theguardian.com/business/2018/nov/13/call-for-boycott-of-ftse-350-firms-without-a-woman-on-the-board
[26] https://www.gov.uk/government/publications/ethnic-diversity-of-uk-boards-the-parker-review

than half of the FTSE 100 Boards are exclusively white and in 2018 it was reported that the number of FTSE 100 minority ethnic board directors had actually declined[27].

Therefore, in our survey we judged a fund manager to have a voting policy on women or ethnic minorities on boards only if they made specific references to these in the policy. If they only made a general reference to "diversity" we did not consider that sufficient to indicate that the fund manager was truly engaged on either issue.

5.5.1 Red Line policy: gender diversity

The Red Line policy on gender diversity is as follows:

Vote against the re-election of the chair of the nomination committee if there is no strategy in place to address any underrepresentation of women at board level and fewer than 25% of the company's board members are female.

Those who referenced support for industry initiatives of which gender diversity plays a role, but with no connecting reference to how that translates to a voting policy or guideline, were not given credit.

5.5.2 Findings

Below is our analysis on the voting policies of fund managers with regard to gender diversity. The Red Line referred to a dissenting vote should there be no strategy in place to address gender diversity. We therefore looked at whether the fund managers' voting policy made any reference at all to gender diversity and if so whether there was a voting guideline.

4 fund managers did not disclose their voting policy

12 fund managers did not reference gender diversity in their voting policy

16 fund managers referenced gender diversity but had no voting guideline

11 fund managers had a voting guideline, however 6 of them either did not reference gender specifically when stating their voting guideline or if they did, it was only in reference to shareholder resolutions

Of those that publicly disclosed a voting policy (38), over 30% of fund managers made no reference to gender diversity on boards. Considering the extent of government and regulatory action on this matter, this is surprising. It is not surprising, therefore, that the progress being made in getting more women onto company boards is so slow, since those who are holding for themselves the power to use shareholder votes appear to be choosing not to do so and refusing to operate asset owner policies that would take this matter seriously. As with climate change, this seriously calls into question the degree to which they take these matters seriously or at a minimum, the degree to which they execute these policies in a consistent manner as possible across companies. This is especially true of those fund managers who do not even publicly disclose the voting policy itself and/or indeed their voting records. For those

[27] https://www.theguardian.com/business/2018/oct/12/top-firms-failing-to-increase-number-of-ethnic-minority-directors

managers specifically, asset owners are left with little to infer other than they lack strong commitment to the issue.

We find it disheartening that a further 40% of fund managers had no stated policy on how they will or may vote if the company does not meet their expectations with respect to gender diversity. We are concerned by the amount of what seem like "boiler-plate" policy statements which appear to have simply been copied and pasted from a pro-forma policy. For example, 10 fund managers making similar statements about the importance of diversity and that companies should have diverse boards, but not disclosing what the consequences would be for lack of adherence to this expectation, is neither helpful to asset owners nor sufficiently publicly accountable.

We also find it disappointing that fewer than a third of fund managers had a voting guideline on gender diversity, of which a substantial portion refer to looking at many diversity factors, including gender, in determining their voting decision. Similar to comments made above, this may also be a contributing factor to the slow progress on tackling gender diversity on UK boards, if the voting guideline is not specifically directed at gender diversity.

5.5.3 Red Line policy: ethnic diversity

The Red Line policy on ethnic diversity is as follows:

If there is no diversity strategy in place to address a lack of minority ethnic representation at board or senior management level, and there is no visible minority representation at that level, vote against the chair of the nomination committee.

Two policies referenced "cultural" or "international" diversity. Some boards with substantial sales in overseas markets have a legitimate desire to ensure high level representation of executives from those countries in order to understand that market, be cognisant of cultural sensitivities and avoid errors arising from linguistic or cultural ignorance – but this does not address the under-representation of UK minority ethnic representation on the company board.

5.5.4 Findings: Ethnic Diversity

4 did not have a public voting policy

28 did not refer to ethnic diversity in their policy

6 had a voting policy but no guideline

4 had a voting guideline but for either diversity in general or for supporting shareholder resolutions

Of those that publicly disclosed a voting policy, nearly 75% of fund managers made no specific mention of ethnicity with regard to board diversity and a little over 10% had any voting guideline on the issue. Given the Parker review and specific reference to ethnicity in the UK Corporate Governance Code since 2014, we are disappointed that the numbers of fund managers even mentioning it are so shockingly low. It is no surprise that ethnic diversity on

FTSE 100 boards has declined[28] since there is almost no pressure from the fund management community to improve. It is our view that this slowness of response to regulatory developments indicates a lack of investment belief on the materiality of the issue. This result is especially frustrating considering that asset owners who wish to adopt best practice in this area (such as Red Line adoption) cannot do so because fund managers are refusing to accept their policies.

We received feedback from one fund manager that the lack of available data from proxy voting agencies may be contributing to the problem. Whether or not this is the case, this should not be an excuse for inaction as if the issue was considered material to the fund manager, they would not hesitate in trying to resolve it by pressing investee companies or proxy voting agencies to provide such data, collaborating with other fund managers as necessary.

The acceptance of ethnic diversity as a serious issue for investors to consider seems to be taking a similar trajectory as gender diversity when it was at an earlier stage of awareness raising. Lessons should be learned from the journey that gender diversity has taken over the past 10 years so that the issue can be accelerated to the level of awareness that it deserves. We believe this requires immediate action to resolve in order to protect the sustainability of clients' assets over the medium to long term. It is also an issue that, as with gender, impacts many pension scheme beneficiaries.

5.6 Policy issue: Executive Pay

Executive pay is a complex issue which polarises investors. The predominant manner in which fund managers address excessive executive pay appears to be through the mechanism of pay versus performance. In addition, there is an apparent general fatigue expressed by the fund management industry in that too many resources are spent on addressing this issue. On the other hand, the government, the media, pension trustees, company workforces and the general public have shown great concern at executive pay, having reached such excess that according to the High Pay Centre it takes the average CEO just three days to earn the same amount of pay that an average worker in the UK would earn in a year[29]. This misalignment between fund manager views on executive pay and the general public (and thus beneficiaries) was also highlighted in the aforementioned BEIS Select Committee report. One witness from the report noted: "They [fund managers] care about levels of executive pay a little less than the public probably does" and therefore will "apply less pressure here than the public might like".

It is also important to note the issue of excessive pay remains a very live issue for asset owners from a reputational risk perspective (especially given the financial crisis). For DC schemes that consider members' views as part of their stewardship approach, or simply wish to show that they are managing excessive pay as a financial risk, fund managers may find themselves having to better defend their approach to excessive pay in the future to remain aligned with clients'

[28] https://www.theguardian.com/business/2018/oct/12/top-firms-failing-to-increase-number-of-ethnic-minority-directors

[29] https://www.theguardian.com/business/2019/jan/04/uk-ceos-make-more-in-first-three-days-of-2019-than-workers-annual-salary

best interests. We believe that the new Stewardship Code should have an important role to play in this area.

The UK government prioritised the issue of excessive pay in its August 2017 White Paper and stated that companies must disclose their CEO-worker pay ratio. The recent BEIS report also makes reference to the importance of relating the setting of executive pay to that of the workforce.

5.6.1 Voting Policies and Guidelines on Total Remuneration

As previously stated in this report, AMNT conducted a qualitative analysis on the voting policies and guidelines, where present, of the fund managers on total remuneration as defined previously (see Taxonomy on page 13). We identified the following issues as a matter of concern:

- The use of ambiguous language such as companies should pay what is “necessary”, “reasonable” or “acceptable” or pay “should not be excessive”, without further explanation as to what that means in practice

  “…volume of additional compensation should be reasonable...”
  “Overall quantum should not be excessive”
  “Remuneration should be reasonable”
  “We expect remuneration schemes to contain an adequate but not excessive level of fixed pay”
  “….expects companies to pay no more than necessary”

- Linking of an executive's pay with other factors to determine what is deemed excessive, whether it be relative to peers, sectors, or most notably performance, which may do little to address the 'arms race' of CEO pay

  “The level of pay for the CEO and members of executive management should not be excessive relative to peers, company performance, and market practices”

  ”[We will focus on] the level of compensation as compared to industry peers”

- A few fund managers explicitly stated that excessive total remuneration was not a priority:

  “**We are not averse to high pay** so long as it rewards exceptional performance by company management. Although quantum is a very important consideration, we think the stewardship approach to executive pay should include a rigorous analysis of strategic execution and whether a company’s pay framework incentivises appropriate management behaviours and strikes a balance between short and long-term growth”

  (with regard to quantum) “**Whilst this is not our primary concern**, excessive pay can represent a risk to the company both in terms of encouraging the wrong behaviours within the firm and also for the reputation of the company itself. We will make our

assessment on the explanations companies provide for the overall pay levels, the need for pay increases and other exceptional factors"

"[We] will generally support management's recommendations with regard to the components and levels of executive compensation"

- The over-reliance on the following concepts, with again no information as to what it means in practice

  "Remuneration should be in "**alignment with shareholder interests**"
  "Pay packages should be sufficient to attract, motivate and retain management"

- An over-reliance of the remuneration committee to resolve issues of excessive pay, (one fund manager added that it is not the role of shareholders to micromanage companies)

` "……..role of REMCO to ensure quantum is appropriate……."

"Appropriate remuneration levels is primarily the responsibility of the remuneration committee of the board and will be a market-based judgement and must depend on responsible and well-informed judgement on the part of remuneration committees"

"We expect remuneration committees to be mindful of the overall quantum of executive pay and the related risks"

"The remuneration committee should be composed of independent (non-executive) directors only and is responsible for ensuring that remuneration is reasonable in both structure and quantum"

- Those who were concerned about excessive pay often focussed on one aspect of the pay package such as bonuses, or basic pay, or share options, rather than looking at overall quantum which again may not address the issue

- Based on our analysis, few fund managers (approximately 25% of those that published their policy) had a voting guideline on tackling excessive *total* remuneration in some form.

AMNT believes that the use of ambiguous and seemingly boiler plate language, coupled with the small number of fund managers disclosing a voting guideline, leaves asset owners with little information as to ascertain how seriously the fund manager takes the issue. Further, a significant number of fund managers appear to have discounted total remuneration as part of their assessment by either explicitly saying so, or indirectly by stating that their definition of excessive is relative most notably to peers and performance. The over-reliance on the role of the remuneration committee is also a notable concern because a lot of fund managers use the independence of the remuneration committee as the metric to evaluate their effectiveness in their role, which we believe may be over-simplifying the issue. One stated that it is not their role as shareholders to weigh in on this issue, an attitude which is alarming because it begs the question: why is this not a priority for fund managers, when the issue may be important to the

people whose money they are managing? And if it is not a priority for fund managers, and asset owners are prevented from intervening, then whose responsibility is it?

We also concur with the BEIS report regarding the potential concern of conflicts of interest within the highly paid fund management industry, an issue that also needs further exploration by the FCA.

In order to delve into this qualitative analysis further and given the government focus in this area, the next section explores fund managers' voting policies and guidelines regarding total remuneration related to that of the workforce.

5.6.2 Red Line policy: Total Remuneration vs Workforce

The Red Line policy used as a benchmark for the analysis was as follows:

Vote against the remuneration report or policy if the total remuneration package of any director is more than 100 times greater than the average pay of the company's UK workforce, other than in exceptional circumstances which must be fully justified.

In surveying fund managers' approach to this issue, AMNT studied whether:

- Fund managers had any policy setting out any relationship between executive pay and that of the company's workforce;
- Fund managers were seeking company disclosure on the CEO pay ratio relative to the workforce, either as one of several factors that would trigger a vote against management or as a factor that on its own would do so; and,
- Whether there was a corresponding voting guideline linking executive pay to that of the workforce or specifically on pay ratios

5.6.3 Findings: Workforce remuneration

4 did not publicly disclose their voting policy

16 had no voting policy or guideline relating to workforce at all

17 had a voting policy only of which only 4 reference pay ratio specifically

3 had a voting guideline which considered workforce in addition to other factors, of which one only referenced pay ratios

2 had a voting guideline which was specifically triggered by workforce pay, but none connected to pay ratios specifically

These findings on total remuneration vs workforce pay indicate that the CEO worker pay ratio were largely being ignored by fund managers in determining what is considered "excessive", despite some limited disclosures on executive pay relative to the workforce (and indeed the ratio itself) being mentioned. At an absolute minimum, this metric should be used in the round with other metrics and form part of a wider dialogue with companies on how they incorporate the workforce into their executive pay arrangements. This dialogue should also be

extended to include human capital discussions about employee satisfaction and other related metrics. Finally, we believe it is important that the FCA and FRC take heed of these findings in light of government support for consideration of the workforce in setting pay arrangements[30]. The recent BEIS Select Committee report stated that "to help tackle excessive pay awards and deliver fairer rewards across businesses, the BEIS Committee calls for a stronger link to be made between executive and employee pay, recommending businesses make greater use of profit-sharing schemes, and that companies are required to appoint at least one employee representative to their remuneration committee".

5.6.4 Findings: Remuneration-related Voting Records

Finally, we studied how the fund managers voted on the remuneration reports of 28 FTSE 100 companies that had been identified as breaching the above Red Line.

AMNT commissioned Manifest, (now named Minerva Analytics), to provide AMNT with a sample of FTSE 100 companies that were paying their CEO total remuneration of more than 100 times the average pay of their workforce.

We then reviewed how each fund manager voted in the 2017 voting season on the remuneration report for each of the companies in breach of 100 times the average pay of the workforce.

Table 3 shows the companies, the CEO-workforce pay ratio, and how the fund managers voted:

Table 3: Voting Records

Company	CEO-workforce pay ratio	Number of fund managers voting for the rem report	Number voting against	Absten-tions		Company	CEO-workforce pay ratio	Number of fund managers voting for the rem report	Number voting against	Absten-tions
Anglo American plc	105.72	19	2	0		Mondi plc	136.82	18	1	0
Associated British Foods plc	253.65	18	1	0		Next plc	136.52	21	0	0
AstraZeneca plc	162.05	9	13	2		Randgold Resources	792.50	15	3	0
Berkeley Group Holdings plc	382.34	15	2	0		Reckitt Benckiser plc	422.10	17	5	1
British American Tobacco plc	287.86	18	5	1		RELX plc	186.81	17	3	2
Carnival plc	1333.23	13	10	0		Rentokil Initial plc	163.94	19	1	0

[30] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/640470/corporate-governance-reform-government-response.pdf
https://www.frc.org.uk/getattachment/88bd8c45-50ea-4841-95b0-d2f4f48069a2/2018-UK-Corporate-Governance-Code-FINAL.pdf

Compass Group plc	345.10	21	3	0		Shire plc	443.19	16	3	1
CRH plc	210.44	15	4	3		Sky plc	279.47	2	13	1
DCC plc	108.31	19	1	1		Tesco plc	193.25	19	1	0
Direct Line Insurance plc	110.78	20	0	0		Unilever plc	217.20	24	0	0
DS Smith plc	113.13	16	0	1		Vodaphone Group plc	137.40	22	0	1
G4S plc	536.15	14	2	0		Whitbread plc	133.46	19	0	0
Imperial Brands plc	182.41	21	2	0		WM Morrison Supermarkets plc	163.55	2	15	2
Intertek Group plc	198.76	21	0	0		WPP plc	826.54	13	9	0

Source: Minerva Analytics

We examined how fund managers voted against remuneration reports. Five fund managers voted against the remuneration reports of only one of the companies listed above. Eight fund managers voted against two and a further eight voted against the remuneration reports of 3- 5 companies. Just one fund manager voted against more than they voted for (11 for and 14 against). Not all fund managers invested in these companies.

We also looked at voting in favour of the remuneration reports of these companies. 13 fund managers voted for the remuneration reports of 20 or more of the companies, including one that voted for all but one of the 28 remuneration reports. Seven fund managers supported between 14 and 19.

In the light of these votes it is hardly surprising that 20% opposition to a remuneration report is considered a major shareholder rebellion.

5.6.5 Conclusion

We readily acknowledge that voting records themselves do not tell the whole story. Even when fund managers vote against a company it may not be due to concerns about excessive pay - it could be, and indeed in many cases we believe it was, due to other factors. By the same token those voting for a company's remuneration report may do so despite concerns about excessive pay because the fund managers believe that other factors outweigh this. It is not possible to get to the bottom of this because too many fund managers do not provide an explanation for the way they voted or for a few it is too difficult to access voting records.

It is extremely disappointing that the fund management community clearly does not share the degree of concern of AMNT, the government, the BEIS select committee, FRC, workforces, trade unions, the media and the general public about excessive pay. We believe that they are failing to send the right signal to companies that excessive pay awards are inflammatory and damage confidence in both corporate governance and stewardship. Some are clear in their voting policies that it is not a priority, or that they believe that the matter should be left to the remuneration committees. What is worse is the large number of fund managers who have refused to accept asset owners' voting policies that could have led to a different voting outcome.

The UK Corporate Governance Code makes clear that the remuneration committee “should be sensitive to pay and employment conditions elsewhere in the group especially when determining annual salary increases.” It is not in the shareholders’ interests for companies to

ignore this matter as doing so may cause a range of problems such as internal resentment, falls in productivity, industrial unrest, reputational damage, fall in output and fall in shareholder value. If the average wage in a company is approximately the national UK median annual earnings for fulltime employees of about £27,000 per year, a director earning 100 times this would be paid £2.7-million. Too many fund managers either make loose reference to it In their voting policy but it is not clear how they follow up on it In terms of their voting guideline, or make no reference to it at all.

We share the view of the Prime Minister and the BEIS select committee that there is great merit in the use of pay ratios as a measure of excessive pay. The greatest leaders are those who are felt to be part of the team they lead, and linking CEO pay with that of the workforce through ratios is an effective way to demonstrate this (indeed, academic studies have shown a correlation between CEO pay ratios and employee satisfaction). No one metric is going to perfectly capture the complex issue of executive pay, and indeed the AMNT's Red Lines have other metrics forming part of its executive remuneration section.

The BEIS report states that “ultimately, it is up to asset owners to give any direction on the stance to be taken by asset managers on corporate governance issues, including executive pay, and to hold them to account”. But when that asset owner has given such direction to their fund manager and the fund manager has refused to accept their direction, even on a comply or explain basis, what is the asset owner to do then? What recourse is available to them? Some have suggested that they should find another fund manager more in alignment with their views, but as our review and indeed the BEIS report indicates, there is an industry-wide problem with respect to fund managers having weak stances on excessive pay.

5.7 Updated voting policies

Given that our analysis was conducted in the first half of 2018, we felt it was prudent to review any voting policies that were published after this period **up until the end of 2018** in order to note any changes/improvements and also, more importantly, to determine whether the findings of such review would alter our conclusions and recommendations. Six fund managers updated their voting policy after our review was undertaken. A review of their voting policies and guidelines on climate change, gender and ethnic diversity, as well as remuneration, found:

- One fund manager that had had no voting policies or guidelines on climate change brought in a policy but no guideline.
- One fund manager included new voting policies and guidelines (the latter for shareholder resolutions only) for a 2 degree scenario
- Two fund managers introduced voting guidelines on gender diversity (one additional fund manager did not note a similar change in their voting policy, but did state in the press that they had introduced one)
- One fund manager introduced a voting policy on executive pay which specifically highlighted pay ratios
- Two removed an entire section of voting guidelines on executive pay matters from their new versions

The two fund managers' removal of voting guidelines on excessive pay from their new voting policies, given the regulatory pressure to tackle excessive pay is surprising and disappointing.

We also noted a few references to the Climate Action 100+[31] collaborative engagement initiative which targets the world's largest corporate greenhouse gas emitters. As it was launched in December 2017 and is a five year program, it is too early to determine the impact and success this initiative will have in the future, however we note that there does not appear to be any voting element to this program, only collaborative engagement. This was one criticism laid down by a group of NGOs in their June 2018 letter[32] to the Chief Executive Officers of the 327 investors who signed up to the initiative. In their response to the NGOs, Climate Action 100+ responded that it was up to the individual investors to decide how they should use their vote. Irrespective of the growing signatories to this initiative, this does not excuse fund managers from being more transparent and accountable about their own approach to climate change in their public voting policy. A reference to being a supporter of this initiative Is not sufficient.

In our view, the findings of this updated review do not alter our analysis, conclusions and recommendations represented in this report.

5.8 Fund manager feedback

Two distinct issues were identified in the fund manager feedback. We wish to make policy makers aware of the key arguments being presented by the fund management industry – and most importantly AMNT's response as to why they are not appropriate – regarding increased transparency and accountability on voting policies so that we can more effectively move forward on developing solutions to this issue.

Referral to stewardship reports or voting records

As stated earlier, some fund managers, who had made no reference to climate change/diversity in their voting policy or only had a voting policy and no guideline, stated that they do consider these issues in their stewardship activities, and we were asked to refer to their stewardship reports and voting records for evidence of this fact. Given the regulatory climate, voting policies as well as guidelines need to be explicitly mentioned within the voting policy so that:

- Asset owners can proactively hold their fund managers to account for their stewardship approach **in advance of the voting season and not after the fact**. Further, with full transparency, the asset owner can better establish the link between the fund manager position on the issue and whether or not they follow through on it throughout the course of the proxy voting season. Focussing only on a fund manager's outputs without the appropriate reference in their policy is not full transparency and accountability in our view.
- Asset owners have sufficient information so as to differentiate between fund managers as part of their selection and/or on ongoing monitoring processes. If the level of transparency is not comparable or consistent between fund managers on

[31] http://www.climateaction100.org/

[32] https://www.businessgreen.com/bg/news/3074032/use-your-influence-climate-action-100-investors-urged-to-step-up-lobbying-efforts

these issues, how can asset owners conduct an effective selection exercise and rank them accordingly?
- Investee companies have clear expectations in advance of the AGM as to investors' expectations of them. Investee companies have in the past charged investors with weak or inconsistent signalling across issues of concern, so increased transparency and accountability in the voting policy would seek to address this.

We acknowledge that fund managers may produce private, mandate-specific client reporting on ESG issues, in addition to the firm-level aggregate reporting that is publicly available. However, we believe that the quality of client-specific reporting (as well as public stewardship reporting) within the fund management industry is simply not sufficient for asset owners to be able to reasonably map the issues and companies of concern to them with how their fund managers have specifically addressed them. In general, reporting consists of highlighting issues that the fund managers, not the clients, have selected to raise, with an over-reliance on case studies to communicate their commitment to the issues of concern. It was this concern regarding the quality of stewardship reporting that prompted 16 UK asset owners to produce the *Guide to Responsible Investment Reporting in Public Equity*[33] (2015) which provided suggestions for improvement for the fund management industry to consider.

Flexibility

Some who did not have a voting guideline stated that they did in fact have one internally, but they did not wish to disclose it in order to give them the freedom to apply it as and when they considered it appropriate (e.g., sector-based approach). We agree that some degree of flexibility is important, as highlighted In the Red Line Voting Initiative section of this report, but on an exceptions basis so that abuse does not occur; and we do not see why these different approaches cannot be made public. More important in our view is that the fund manager is sufficiently transparent about their stance(s) on the issue such that should they wish to deviate from that stance, they have to publicly disclose a robust argument as to why the deviation was necessary. This would give the asset owner and indeed wider society (including investee companies) greater comfort that there was a robust internal governance mechanism as to how the policy was implemented. Without these checks and balances, it calls into question just how robust the policy is.

[33] https://www.plsa.co.uk/Policy-and-Research/Document-library/Guide-to-Responsible-Investment-reporting-in-Public-Equity-Published

6 CONCLUSIONS AND RECOMMENDATIONS

The four questions that drove AMNT to undertake this review were:

- How many fund managers are in fact prepared to accept their clients' voting policies in pooled funds?
- How did fund managers' public voting policies compare to AMNT's Red Line Voting policies, which cover ESG considerations and are derived in the main from the UN Global Compact and UK Corporate Governance Code?
- How publicly transparent were fund managers on their voting policies and practices? Was there sufficient information in the public domain, presented sufficiently clearly, such that an asset owner, seeking to benchmark a fund manager's voting policy against its own during the selection process, can conduct an effective comparative analysis?
- How much variation is there in voting policy across the fund management industry? Is there in fact any real consumer choice?

Fund manager acceptance of client voting policies

Given the regulatory pressure asset owners face with regard to the development of stewardship policies, AMNT was disappointed with the opposition received by the fund management sector to accept client voting policies in split voting arrangements.

- As indicated by the Pensions Minister, operational and technological challenges should be addressed by a long overdue investment in the voting infrastructure system. If this is resolved, this will also solve a lot of the issues relating to cost, which we feel is an insufficient argument in any case given the fees paid to fund managers, and their profitability rates of 38%.
- Concerns from the fund manager regarding the lack of client demand in fact represent, in our view, an effort to suppress demand and an excuse for inaction. It also fails to recognise the increased regulatory requirements of trustees which will no doubt increase demand, and as a result, the need for fund managers to reshape their business models in order to accommodate them. This also connects to the argument regarding the need for a stronger signal to companies – how does that relate to the need for DC schemes to consider their particular beneficiary base in the crafting of their stewardship policy? The Pensions Minister has also recently queried as to why a diversity of views cannot be communicated to companies.

Overall, the response appears to have similarities with the debate over fee transparency which dragged on until FCA intervention and an independent review panel determined that action was required**.** We believe that the expression by some fund managers of a willingness to engage with others in the industry on this issue reflects an admission that there is a problem and we believe that this requires regulatory intervention.

Fund managers voting polices versus Red Line voting

Based on our research, few fund managers had what AMNT considers best practice voting policies and guidelines on climate change, gender and ethnic diversity, at least that are publicly available. Less than 10% (on average) of fund managers were as robust and publicly transparent as the Red Line voting template. AMNT has been told that trustees should delegate all stewardship matters to fund managers as they have the superior expertise. But our review discredits this in demonstrating how far behind too many fund managers appear to be in adhering to best practice. For example, the number of fund managers who do not even refer to climate change and ethnic diversity in their policy, or low percentage of dissenting votes against management for companies whose executive pay is out of line with the workforce. This creates doubt in the asset owners' mind as to how aligned they are with clients' interests, and whether these issues are being taken seriously. This makes it even more imperative that trustees are able to implement their own best practice voting policies, such as Red Line Voting, on a comply or explain basis and the fund managers should be accountable for their actions.

Public transparency and accountability

Disclosure and transparency engender trust in the market. AMNT has been told by some fund managers in their feedback that whilst the issue may either not be referenced in the public document or only as a policy, that it should refer to their voting records and stewardship report as evidence of their support for the issue. Just as asset owners have access to estimated costs and charges in advance of the reporting year, as well as confirmation at year end, so they should be able to **proactively** hold their fund managers to account for their stewardship approach in advance of the voting season and not merely after the fact. Further, with full transparency, the fund manager can better establish the link between the fund manager position on the issue and whether or not they follow through on it throughout the course of the proxy season. Only focussing on a fund manager's outputs, without the appropriate reference in their policy, is not full transparency and accountability.

We have also highlighted an issue with regard to the quality of stewardship reporting, but at a mandate and an aggregate level. Even full disclosure of the voting records is of limited use to the asset owners if the voting records are not accompanied by any explanation of why they voted the way they did or may be presented in a way that makes it inaccessible for trustees.

AMNT has also been told that the lack of public transparency on these issues is due to the need for flexibility in their stewardship approach, which could stem from anything from the size of the company, sector-based approaches, to allowances for engagement escalation amongst considerations. In our view, fund managers are allowing too much flexibility in applying their policies should they indeed have any, to such an extent that it hinders accountability, and makes comparability impossible from a competition perspective. As previously stated, it also begs the question as to why the fund manager wishes to be so opaque in their approach to said issue – it casts doubt in the mind of the asset owner client as to how seriously they take the issue if they are not prepared to state what they may do to register dissent to a company. We support some degree of flexibility in stewardship (indeed we welcome it in some cases) but it is a huge hindrance to client trust and market competition, if asset managers contracting with trustees accept no contractual constraints whatever in their

voting practices, and insist on maximum asymmetry of information via secret policies and case-study based reporting. This level of transparency is also important for investee companies so that they have a clear understanding of investors' expectations of them. Investee companies have in the past charged investors with weak or inconsistent signalling across issues of concern. Increased transparency and accountability in the voting policy would also seek to address this.

Voting policies and consumer choice – is there a market for voting policies?

Our review demonstrates beyond doubt that there is no real market in voting policy due to insufficient transparency. Too many fund managers' public policies are, in the areas studied, out of alignment with either best practice or asset owners' and societal concerns. A significant number of fund managers are not prepared to publicly state either what their voting policy and/or guideline is. We believe the amount of flexibility being used as an excuse for the lack of transparency is not serving clients' best interests especially in this regulatory environment, and indeed only serves to create doubt as to how serious the fund managers take the issues.

Some fund managers are prepared to provide public reporting after the fact as to what stewardship activities they have undertaken in these areas; however, without the corresponding voting policy or guideline, it is not full transparency and accountability in our view. And whether they state their voting policy and guidelines or not, too many fail to make their voting records easily accessible. This, coupled with those fund managers that only provide public firm-level (versus mandate specific) reporting to their clients, means that even if trustees attempt to exercise consumer choice and compare fund managers' voting guidelines and records against their own policies, this is not a viable proposition.

Recommendations

AMNT asserts that it is time the FCA imposed minimum standards that trustees can expect from fund managers on stewardship, as similarly proposed by Professor Kay in his 2012 review[34]. Based on the findings of this review, we believe that the minimum standards with regard to voting policies should at least include:

- Provision for acceptance of client voting policies to allow them to fulfil their regulatory obligations including within pooled funds
- Public disclosure of all voting policies and guidelines
- Public disclosure of their voting records in a format that is easy for asset owners to interpret and also accessible
- Increased transparency and accountability with regard to the content of their voting policies in one place.
- Improved comprehensive (rather than case study-based) stewardship reporting at client/mandate and firm level

[34] https://www.parliament.uk/business/committees/committees-a-z/commons-select/business-innovation-and-skills/inquiries/parliament-2010/the-kay-review/https://www.parliament.uk/business/committees/committees-a-z/commons-select/business-innovation-and-skills/inquiries/parliament-2010/the-kay-review/

We believe that the lack of minimum standards has contributed to continued chronic under-investment in stewardship over a sustained period. Our review shows that such investment is long overdue and, although modest costs will be incurred, changes have to be made to enable pension scheme trustees to meet the letter and spirit of the new investment regulations and the existing expectations of the Pensions Regulator. This includes the right to direct their own voting policies in pooled funds.

We are therefore requesting that the FCA take urgent steps to investigate this market failure and propose remedies that will enable pension scheme trustees to develop their own stewardship policies and their fund managers to accept them including within pooled funds and operate them at the very least on a comply or explain basis.