Sustainable investment in action

Potential solutions for investors

Willis Towers Watson

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Contents

Thank you to our contributors:

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Sustainable investment is about improving investment outcomes — seeking better returns and lower risk. We believe investors are now rightfully recognizing its central importance in their long-term success and taking the opportunity to embed it within their investment processes.

Last year we wrote "Sustainable investment: translating thinking into action." This update showcases some of what we have been doing to deliver on that concept for our clients. The strengthening regulatory climate has added to the urgency of taking action, but the positive experience of leading asset owners that are successfully integrating sustainable investment is a great benefit to everyone on the sustainability journey.

In the articles included in this brochure we highlight:

- How we have captured long-term sustainability trends in private market allocations
- New tools we have developed to integrate sustainability in risk management and asset allocation
- Our expanding partnership with Hermes Equity Ownership Service (EOS)[1] to strengthen our high-conviction solutions
- A deep-dive research project into current stewardship practices

Altogether, we believe we have a way for all investors to address their sustainability needs. We are fully committed to delivering these potential benefits to client portfolios as we continue to research and develop more solutions to drive the industry forward.

Regulations: the shifting sand underneath sustainable investors' feet

Unlike other countries in Europe, we believe the U.S. government has made the issue of environmental, social and governance (ESG), particularly in ERISA plans, a political one. Consequently, efforts to incorporate ESG issues into U.S. retirement plans have faced headwinds.

The Department of Labor (DOL) has issued multiple guidance documents on ESG considerations into the investments of retirement plans. The DOL's view on ESG has changed with the political alignment of administrations. In 2015, the Obama administration issued "all else equal guidance."[2] Most investors took this to mean that if traditional financial analysis determines two securities are equally attractive, it is prudent for the plan to invest in the more ESG-friendly security. In 2018, the Trump administration issued guidance meant to clarify the 2015 regulation that emphasized investments' financial performance must be first and foremost.[3]

Even more recently, on April 10, 2019, the Trump administration issued an executive order that asked the Securities and Exchange Commission to investigate ERISA plans' use of shareholder engagement as it relates to energy companies.[3] Specifically, the order seeks to determine if ERISA plans are violating fiduciary duty by engaging in shareholder proposals that don't increase a company's financial performance.

Willis Towers Watson maintains that sustainable investment is a financially relevant input in assessing a security's long-term financial performance. We believe our company's approach has consistently aligned with the fiduciary duty of economic value spelled out in the most recent ERISA guidance. While regulations continue to shift like sand underneath our feet, it is our opinion that Willis Towers Watson's approach is consistent: We seek to build out an investment platform that incorporates financially relevant ESG factors into the investment process. To date, Willis Towers Watson is aware of no ERISA plan that has integrated ESG and faced litigation.

Looking to the future

Sustainable investment has come a long way in recent years; however, there is much more to do. At the recent Thinking Ahead Breakfast Seminar, over 75% of the audience agreed that the pace of investor action on sustainability remained too slow.

We fully recognize the role we have to play in accelerating action, not least as an outsourced chief investment officer with $134 billion in assets under management as of March 31, 2019. Sustainability is once again central to the Thinking Ahead Institute's agenda this year, and we are continuing to help investors tackle some of the biggest sustainability challenges including climate change, impact and universal ownership.

We're absolutely committed to be at the leading edge of sustainable investment and help drive industry progress across our research, solutions and client delivery.

[1] Hermes EOS is a team of stewardship experts who engage with policymakers, key industry bodies and oversight organizations, working to raise important, systemic issues and drive positive investment industry change.

[2] Federal Register Interpretive Bulletin Relating to the Fiduciary Standard Under ERISA in Considering Economically Targeted Investments, a rule by the Employee Benefits Security Administration, October 26, 2015, https://www.federalregister.gov/documents/2015/10/26/2015-27146/interpretive-bulletin-relating-to-the-fiduciary-standard-under-erisa-in-considering-economically.

[3] U.S. Department of Labor Employee Benefits Security Administration, Field Assistance Bulletin No. 2018-01, April 23, 2018, https://www.dol.gov/agencies/ebsa/employers-and-advisers/guidance/field-assistance-bulletins/2018-01.

Real asset solutions: Compelling sustainable investments

Here is a sample of investments we have made as part of our secure income and multi-asset pooled fund solutions. Some of these investments were also made by our segregated delegated accounts and, in some cases, also by our advisory clients. It is worth noting that not all of these required a long lock-up, and even those that did are often tradeable on the secondary market, opening up targeted sustainability opportunities to some investors.

Advanced greenhouses for more sustainable agriculture

- Provided project finance for advanced greenhouses in North America, with numerous environmental benefits including improved crop yields and reduced water consumption, soil erosion, use of chemicals and transportation
- Committed $40 million.
- Specialist manager focused on technology-driven agriculture in an emerging sector of controlled food production

Coinvestment into a leading medical training institution

- A for-profit educational institution specializing in medical training
- Addressed the chronic skills shortage of suitably qualified medical professionals available to meet the increasing U.S. demand
- Coinvestment with a differentiated private equity firm focusing on long-term, actively owned investments
- Increased returns tied to key emerging educational and health care trends

Investment in Japanese solar farms – global solar

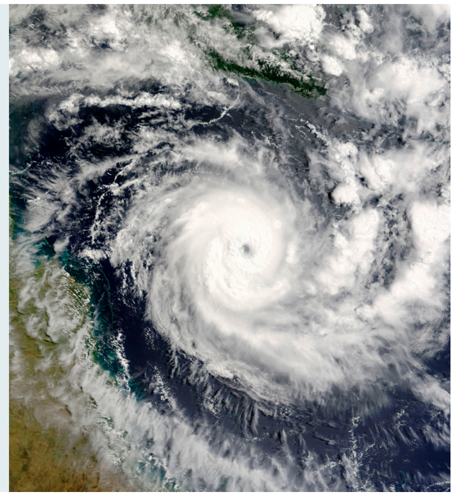
- Capacity has quadrupled in the last five years, with the third-largest increase in 2017 coming from Japan
- Coinvestment with one of Asia's largest independent infrastructure managers that specializes in the development, construction and operation of solar projects across Asia Pacific

Temporary accommodation for vulnerable families

- Targeting an attractive and underexplored real estate subsector to deliver strong inflation-linked returns supported by the government
- Negotiated attractive fee schedule and fund terms to ensure robust investor governance rights
- Strong inflation-linked, government-supported returns delivering wider societal benefit in helping to address the U.K. homeless challenge

Supporting business resilience and climate preparedness

- Advancing corporate resilience and business preparedness for climate change and volatile weather patterns
- Long-standing investors in a manager's products indirectly financing and providing insurance against natural disasters and weather volatility
- Excellent diversification and risk-adjusted returns from insurance-linked investments
- Supported a manager with constant innovation in weather-related insurance products
- Leveraging our internal insurance experience as a company to deepen our manager research in niche areas



Venture capital to harness scientific research

- Leveraging the intellectual power and capacity of the University of Oxford faculty and resources
- Coinvestment with a venture capital firm to finance businesses and projects coming from the University of Oxford's scientific and medical research departments
- Investing in difficult-to-access, unique and innovative entrepreneurial projects and start-ups

Specialist social housing for disabled adults

- Providing long-term capital to a developer and manager of social housing projects to address the chronic shortage of affordable specialist housing
- Coinvestment to provide specialist-supported housing in the U.K.
- Worked with a manager to structure a fund with attractive fees and governance on an exclusive basis, including being on the investor advisory board
- Increased returns while also contributing to wider community benefits

Investing in U.K. solar farms

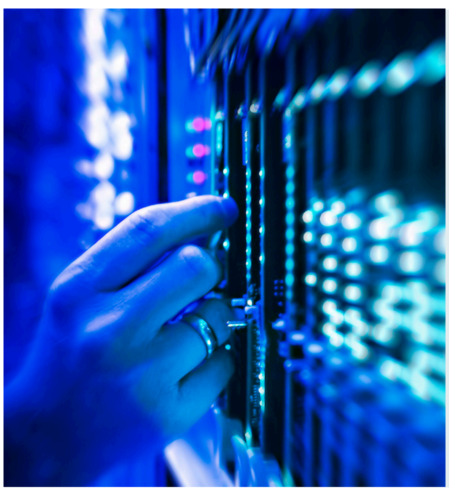
- Invested with one of the U.K.'s largest independent managers sourcing capital for U.K. farms and handling megawatts of energy generation capacity
- Members of the investor advisory board to provide in-depth, ongoing stewardship
- Strong inflation-linked risk-adjusted returns while also contributing to wider environmental benefits and the U.K. decarbonization agenda

Unlocking hydropower energy in Scotland

- Hydropower is the largest global source of renewable energy
- Coinvested in a Scottish hydropower development working with a specialist mid-market European infrastructure manager

Early mover investments in government-backed social infrastructure

- Seed and subsequent fund investments with skilled manager aligned to U.K. National Infrastructure Delivery Plan to invest in housing and social infrastructure
- Seat on Investor Advisory board, negotiated improved fund terms, significant fee discount and seed investors in first fund
- Stable contractual cash flows in long-duration inflation-linked assets, providing tangible wider economic and societal benefits



Coinvestment opportunity in early stage cybersecurity venture capital

- Supported by significant tailwinds from technology and digitization, coinvested with a venture capital specialist with a 20-year track record in cybersecurity
- High expected returns from access to niche venture capital opportunities linked to emerging risks and technological change
- Cybersecurity continues to represent a growing threat globally with cybercrime cost estimated to reach $6 trillion by 2021[4]
- Benefits from our company's cybersecurity and insurance insights and experience to strengthen our research

This is a sample representation of our work with an investment manager. Reduced fees may be attributed to other factors besides our buying power, including asset allocations to lower fee asset classes or passive management. Outcomes will vary and there is no guarantee that we can achieve savings with any particular manager in any particular asset class.

[4] 2019 Official Annual Cybercrime Report, Cybersecurity Ventures, December 2018 https://cybersecurityventures.com/cybercrime-damages-6-trillion-by-2021/.

Sustainable investing should be ingrained in real asset investing

In the case of real asset strategies such as property, infrastructure and agriculture, we believe sustainable investing is a natural part of being a successful long-term investor. For example, good property managers understand that developing an energy-efficient building will lead to a broader pool of potential tenants as well as better and less volatile occupancy rates than less efficient buildings. However, even for those investors struggling with this mindset, legislation is now forcing their hand, such as the Energy Act in the U.K.

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Social infrastructure projects, like the building and maintenance of a school, are long-term projects involving work with government bodies, developers and contractors for the collective need of local communities. Given the investments are asset-based in specific locations, technical, environmental and community impact due diligences are often embedded as part of the main investment thesis. We believe it is vital to make sure these kinds of long-term investments have the support of the nearby community, which can help with looking after the assets; as opposed to having a hostile community, which can potentially become a threat to the security of those assets. Therefore, some of our infrastructure managers have implemented charity or education programs in the areas where their assets are based in efforts to create a positive impact in the community, especially when they are in remote, rural areas in a developing country.

Stepping up on governance

In several investment cases we have advocated for, the investment managers agreed to one or more independent investment committee members being appointed as part of the governance oversight. These independents have veto rights to stop a fund from making an investment and can bring important insight in considering nonfinancial aspects of investments such as reputational impacts. We believe that improved governance structures directly improve the sustainability of returns in these types of strategies.

Sustainability tools for portfolio management

Our Asset Research team has been hard at work developing tools to help investors understand how to integrate sustainability, megatrend, and climate-related risks and opportunities into their risk management and portfolio construction processes.

Critically, the focus of this work is to help guide practical actions, which can potentially mitigate previously unrecognized risks or target new opportunities that seek to add return. With robust sustainability-related tools, historically an area of market weakness, our team has sought to take advantage of improving data and measurement to create decision-useful analysis and user-friendly output. The development of these tools follows our megatrends project where we partnered with the Principles for Responsible Investment and worked to identify the key emerging risks and opportunities for investors.[5] We highlight three examples across ESG integration, stewardship and risk/return impact.

1. ESG integration: a total portfolio approach to assessing resilience

What does it do?

We calculate a “resilience” score for a total portfolio. This gauge indicates the total exposure of a portfolio to a wide range of sustainability issues, taking into account major structural differences between different asset classes and public and private markets.

How is the score calculated?

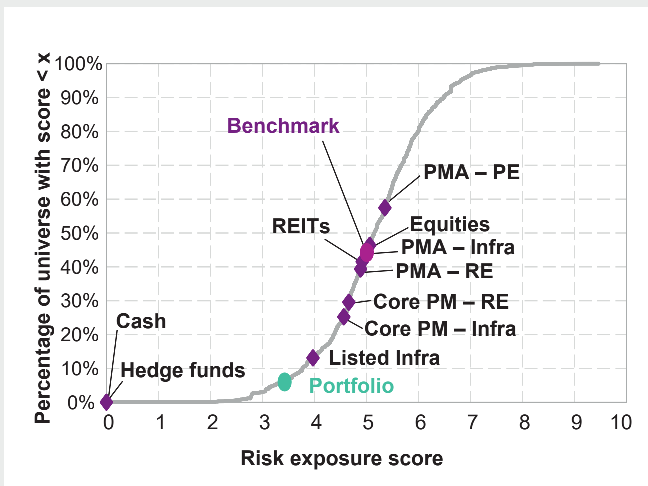
We use big data to identify the sustainability issues that are most material to businesses, regulators and society. We then apply this materiality assessment across a total portfolio by mapping the exposure of different securities and asset classes to these risks.

We also incorporate ESG ratings into the gauge to indicate whether individual assets and the total portfolio are positively or negatively exposed to these issues. A risk exposure score relative to portfolio benchmark is the end result (*Figure 1*).

Why is it useful?

We believe a fund or portfolio achieving a high resilience score should be less impacted by disruptive sustainability trends over the long term, where resilience can be evaluated in absolute terms or relative to a benchmark or peer group.

Figure 1. **Portfolio sustainability risk exposure vs. security universe**



For illustrative purposes only

PMA: Private markets alpha
PM: Private markets
Infra: Infrastructure
RE: Real estate

Resilience scores can also provide a high-level guide to tilting capital allocation to (or from) areas with higher (or lower) scores, thus enhancing strategic asset allocation decisions.

Source: Willis Towers Watson and MSC
Note: The security universe is the broadest set of global equity securities for which ESG quality data is available

[5] Further detail around these megatrends and accompanying report available at www.willistowerswatson.com/en-GB/insights/2017/12/2017-investment-institutions-trend-index.

2. Stewardship: value creation through engagement

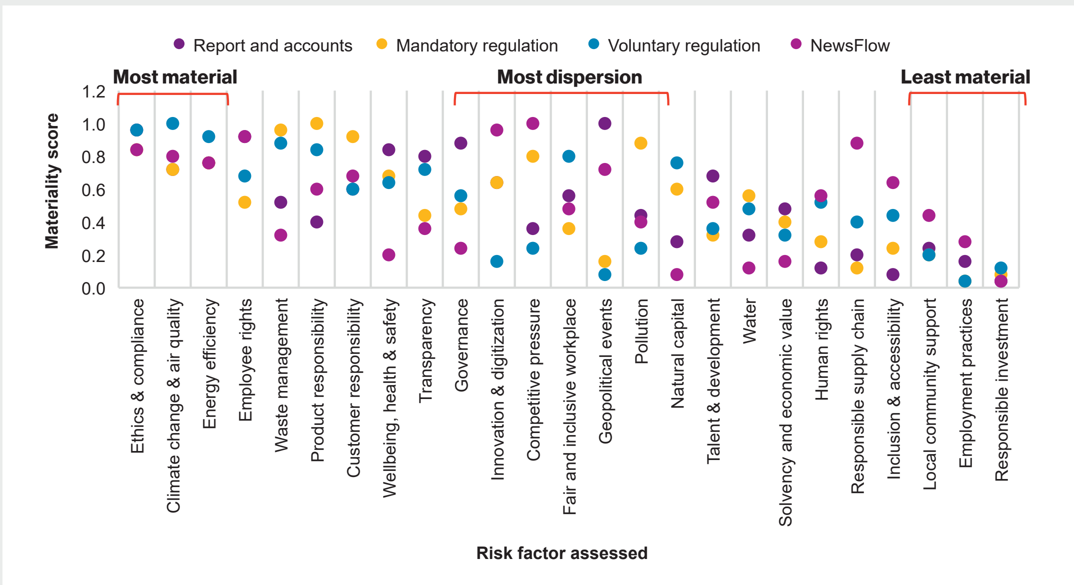
What does it do?

We use big data and natural language processing algorithms to objectively help identify and track which ESG and technology risks are material to businesses at any point in time. We also analyze how businesses are performing on these topics relative to their peer group. Information on the materiality of these topics comes from companies (via their report and accounts), regulation (which can be voluntary or mandatory) and the news media (i.e., distributed, publicly available information). Topics that are highly material for a company or groups of companies are prioritized in our risk monitoring, which guides areas for potential engagement.

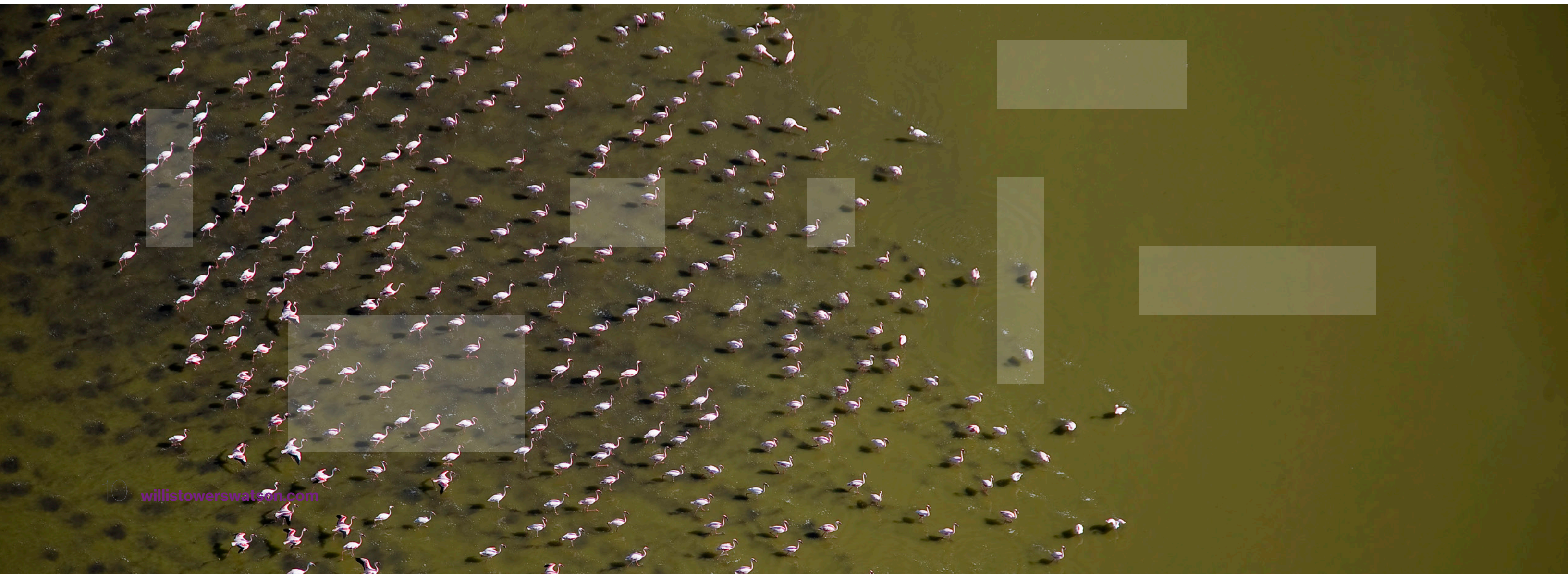
Give me an example

For a global universe of public and private companies, climate change and air quality are material topics for businesses given high levels of new cross-industry, mandatory and voluntary regulations, and greater societal pressures driven by the news (*Figure 2*). However, our analysis of this objectively sourced data suggests local community support is not of material importance to businesses in aggregate despite this being a common area of involvement for their corporate social responsibility teams.

Figure 2. **Materiality map across risk factors**



Source: Datamaran, Willis Towers Watson



3. Risk, return and impact: climate scenarios for portfolio and business strategy, and gauging environmental impact

What are climate scenarios?

Scenario analysis helps us understand how assets and portfolios may perform under different states of the world, both favorable and unfavorable. For climate change, this crucially involves considering both physical risks and the risks from a transition to a lower carbon economy, and how these are impacted by action or inaction from global policymakers.

How have these climate scenarios been developed?

Our initial inclination was to analyze the impact of climate-driven changes top down – by gauging economic costs/benefits and using the information to infer what the most likely and important changes are for asset class prices. This is a useful first step, but it is not sufficient. To properly quantify the impact of climate change on portfolios or businesses, it is also essential for analysis to be undertaken at a microeconomic level – by looking at the impact of physical and transition risks on operational assets and industry profit pools.

How can you measure physical climate risk exposure?

Sophisticated reinsurance modeling tools can be applied to investment portfolios to help estimate the exposure of individual assets and the total portfolio to a variety of physical perils such as floods, wildfires and cyclones.

We illustrate sample analysis for a real estate portfolio below. In this case (*Figure 3*), we have calculated the exposure of each property to a set of natural perils and summarized their risk exposure using a simple one to five risk score. Scores can easily be aggregated across different assets or funds and compared with benchmarks or peer groups. More detailed analysis allows the estimation of the value at risk for individual assets or the portfolio, which calibrates risk in dollar terms using a metric that is familiar to investors.

Figure 3. **Physical risk mapping and peril scoring**

Aggregate risk score for an Australian direct property portfolio

Risk by peril

Coastal flood	4	Tornado	2	Hailstorm	2
Earthquake	2	Tsunami	2	River flood	5
Flash flood	3	Wildfire	0	Tropical cyclone	1
Lightning	2	Winter storm	4	Volcano	0

Breakdown by peril

	Winter storm	Coastal flood	Flash flood	River flood
Peril score	2.53	1.07	3.25	2.07
% Locations	66%	33%	100%	33%
% Asset valuation	75.4%	26.8%	100%	26.8%

Peril score is an average of each location's score, weighted by total insured value. Percentage exposed indicates the proportion of locations by count or by total insured value with a high risk score for each (3 or higher).

River flood peril scores

Source: Willis Towers Watson

Looking to improve stewardship with Hermes EOS

We believe effective stewardship is a key pillar of sustainable investment. It can protect and enhance the value of assets and is a critical part of a well-functioning investment system.

We are active industry participants, involved in numerous collaborative initiatives, and are vocal proponents for a robust, effective and fair investment industry. In addition to our own work, we have partnered with Hermes Equity Ownership Services (EOS) for the last five years to leverage our public advocacy impact. The Hermes EOS team of stewardship experts engage with policymakers, key industry bodies and oversight organizations working to raise important, systemic issues and drive positive investment industry change. These experts work with their clients to give a powerful voice to critical issues.

More recently, we have expanded our relationship with Hermes EOS and appointed their experts to conduct corporate engagement and provide voting advice. In addition to the stewardship carried out by the fund's underlying managers, Hermes EOS is able to supplement this with its resources and expertise to further enhance the investment proposition. Given the fund size, we believe this additional layer of stewardship delivers compelling value at minimal cost, and access to stewardship that may otherwise be very difficult for all but the largest asset owners to get.

Hermes EOS

- ✓ **Over $580 billion of assets under advice invested in >10,000 companies worldwide**
- ✓ **15+ years of experience**
- ✓ **Global team of 32 professionals**
- ✓ **Engaged with 350 companies on 777 issues during Q1 2019**

Services provided

Corporate engagement

Voting

Public policy

Covering a wide range of issues including:

Climate change	**Executive remuneration**
Human rights	**Cyber security**

Benefits

- ✓ **Protect and enhance performance**
- ✓ **Align management with investors**
- ✓ **Drive industry improvements for a better functioning investment system**

In the United States, Willis Towers Watson's partnership activity is at the public policy level only. Other services mentioned are carried out by Hermes for some Willis Towers Watson clients internationally, but not specifically for those clients that are based in the U.S.

Investor stewardship: One hand on the wheel?

What investment activity, when done well, can mean improved, cost-effective outcomes for everyone: potentially better returns for investors, better run companies and better controlled societal and environmental footprints?

The answer: *stewardship*, where asset managers or asset owners engage and vote to positively influence assets they invest in.

Arguably, we believe good stewardship is the most useful function the asset management industry performs. Unlike trying to outperform a benchmark where there are winners and losers, our evidence suggests that effective stewardship has broad benefits. Regulators expect stewardship to offset potential conflicts where there is separation of ownership and control. Previous examples of inadequate oversight have led to accounting scandals, excessive executive compensation, value-destructive acquisitions, environmental damage and loss of customer trust. We believe that shareholders, as a key system check, along with boards and regulators, do have a stewardship responsibility.

Unfortunately, based on our experience, stewardship activities account for only a very small fraction of asset management industry activity. Why is this so? It is tricky to measure, can involve uncomfortable conversations with company management and is difficult for asset managers to monetize given the free rider problem caused by fragmented ownership interests.

In 2009, referring to the global financial crisis, Lord Myners[6] suggested institutional investors were "asleep at the wheel" when it came to stewardship. Perhaps it is now fair to say investors have one hand on the wheel — at least among some of the biggest asset managers and asset owners.

But there is still more to do. This information is a call to action for the investment community to redouble its stewardship efforts.

Seeking to improve practice

“Passive management” is a misleading label when it comes to stewardship. Increasingly, we have found index managers actively seek to improve the basket of securities within an index by acting as long-term owners.

All the managers in our sample acknowledge their responsibility and the opportunity to create value in this area. They contribute to stewardship at the company level and through various policy initiatives such as the Task Force on Climate-Related Financial Disclosures. All are signatories to numerous local stewardship codes.

It is good to see the transition from a more rules-based corporate governance function to a broader stewardship approach that looks to address key drivers of long-term value creation. The processes and areas of strength differ among managers, which adds diversity – there is no single right way.

Here we highlight positive examples from each of the managers:

BlackRock: voice from the top

BlackRock has clear “tone from the top” from Larry Fink’s well known public annual letters to company CEOs. This has included a public commitment to double resourcing for the stewardship team, which, at the time, was already the largest across the group of managers.[7]

LGIM: climate impact pledge

This is a well-signposted, multiyear campaign to encourage companies to manage their exposure to climate risk. Launched in 2016, Legal & General Investment Management (LGIM) issued a 2018 progress report naming leaders and laggards. While others note climate risk as a priority, the difference here is the level of coordinated effort and strong communication around a particular theme.[8]

LGIM’s Climate Impact Pledge: The results so far

We are publicizing the global corporate leaders and laggards on climate change.

SSGA: gender diversity on boards

Stewardship activity has in the past largely been kept behind closed doors. But if the objective is to achieve broad-based change, then we believe sometimes a creative public campaign is powerful. The Fearless Girl sculpture, commissioned by State Street Global Advisors (SSGA) in 2017, got people talking. SSGA identified over 1,200 companies across the U.S., Australia, Canada, EMEA and Japan without a single woman on their board. They voted against the board chair for over 500 companies in both 2017 and 2018 that failed to adequately address this issue. Partly in response to these efforts, 301 companies added a female director.[9]

Fearless Girl sculpture by Kristen Visbal

UBS: solutions

UBS has created bespoke investment solutions that integrate stewardship, particularly in the areas of climate change and impact. These have been developed by leveraging partnerships with leading asset owners, academics, top universities and in-house intellectual capital.[10]

Vanguard: team construction

Vanguard established its team and has seen it grow significantly over the last few years, including new joiners with diverse functional experience from a variety of backgrounds. This helps them to engage credibly with directors on relevant topics (such as risk, audit, human capital, finance, legal and investments) to assess board strength and quality of process. Vanguard also appears to effectively leverage its relationship with certain active managers.[11]

Call to action

We recognize the efforts made by stewardship teams and acknowledge the encouraging momentum in both resources and activities. That said, we think there is a long way for the industry to go given the limited commitment so far and the significant opportunities to add value.

Below, we set out topics where progress seems slow and discuss how stewardship tools might be better applied.

Some may view the list as stretching, but we would argue that large index managers have a major opportunity and responsibility to bring robust stewardship with deeper engagement models – leveraging their long horizons, breadth of influence and sizable stakes – rather than allowing a stewardship gap to exist following the diminishing interests of traditional active managers.

Topics

Board quality: Boards of corporate or noncorporate entities provide critical oversight. Each of the asset managers in our sample considers this area, but we typically see limited emphasis on the following:

- The effectiveness of the nominations process
- The processes of independent directors: skill diversity, time commitment, available resources, range of duties, level of vigilance, and independence
- Meaningful input on the appropriateness of individuals for board positions

Executive compensation: This area consistently takes up significant bandwidth along with strong shareholder rights, but evolution seems gradual.

Smaller companies: Such companies tend to receive relatively limited attention, particularly if they're in markets away from the domestic base of the index managers (such as Asia).

Capital structure: Deterioration in corporate balance sheets, for example, due to share buybacks, is rarely discussed. A related issue is the challenge of balancing the interests of bondholders and shareholders.

Climate risk: It's on everyone's priority list but, in our view, many progressive initiatives lack sufficient urgency and depth.

Local market norms: We understand that cultural nuances across markets can make pushing against the status quo challenging; however, areas such as the limited gender diversity of boards in Asia or the lack of auditor rotation in the U.S. are often placed in the "too difficult" box.

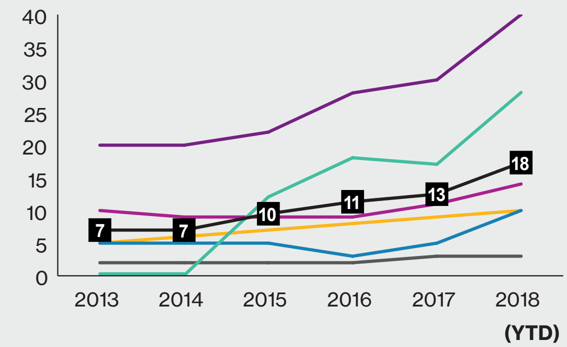
Sensitive subjects: An underexplored area is how personal or political activities, such as corporate lobbying, affect a company's financial value. Without full transparency, we feel it is difficult for shareholders to understand the potential financial and reputational risks or determine if the board is adequately overseeing those risks.

Tools

Resources

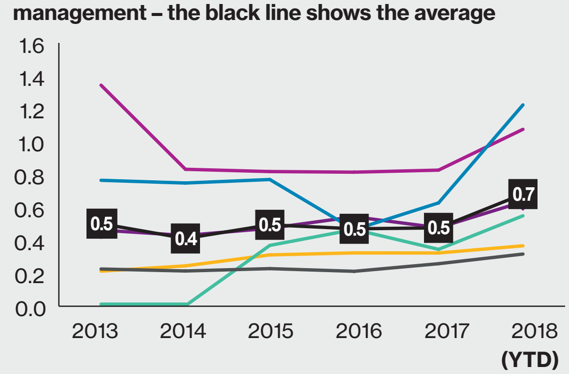
It is encouraging to see that the majority of the organizations in our sample have increased internal stewardship resources over time (*Figure 4*). However, this upward trend is less obvious when compared to total company assets under management (*Figure 5*) and compared to the total number of investment professionals employed.

Figure 4. **Size of stewardship teams over time – the black line shows the average**



Note: Figures supplied by managers; excludes wider firm resources that may contribute to stewardship activities such as internal active investment teams

Figure 5. **Size of stewardship team per $100 billion assets under management – the black line shows the average**



Note: For 2018 YTD, data is as at Q2 or Q3 depending on latest availability; assets data sourced from eVestment

Source: BlackRock, Legal & General Investment Management (LGIM), Northern Trust, State Street Global Advisors (SSGA), UBS Asset Management (UBS) and Vanguard, June 30, 2018

So what's the right number?

The index stewardship team's job specifications are vast given the spread of ownership interests (*Figure 6*): corporate engagement on dozens of complex issues covering close to 10,000 companies, voting on tens of thousands of resolutions, regionally fragmented public policy engagement, research, disclosure and external communication. We believe this practical task list alone necessitates far bigger teams, and the value proposition further justifies increased resourcing.

If just a quarter of a basis point – often merely a rounding error – of every asset invested was directed to stewardship, it could mean far bigger teams than at present.

This can also allow for hiring people with diverse and highly skilled backgrounds including:

- Experienced business leaders
- Technical experts in areas such as the environment or legal
- Those with traditional active management experience

Currently, we believe this type of expertise is often not present.

Figure 6. **The index manager ownership fragmentation challenge**

Note: For illustrative purposes only

Source: MSCI ACWI IMI and MSCI Frontier Markets IMI as of June 30, 2018. Excludes listed companies who do not meet index inclusion rules (free float adjustments, market cap, liquidity, etc.). This number is an approximation, and actual numbers may be more or less than presented above.

Clarity
We observe a lack of tangible, specific milestones around what stewardship success looks like, even on prioritized topics such as remuneration, climate risk or board quality. Perhaps related, we feel stewardship seems to lack urgency and accountability is soft.

This may lead to the pursuit and celebration of inadequate initiatives – in terms of timeliness, scope or magnitude – particularly in pressing areas such as climate risk.

Policies, high-level annual voting statistics and selected anecdotal examples of company discussions paint an incomplete picture. We feel clearer objectives coupled with detailed activity and impact reports on key stewardship themes would allow progress to be measured and enable more engaging communication with clients.

Another useful disclosure would be explanations of voting decisions, including related engagement activity, at controversial annual general meetings.

Levels of transparency around stewardship activity currently differ widely by manager.

Voting
Care needs to be taken when reading into voting records. Sometimes an asset manager will be making significant engagement efforts behind the scenes with good progress on a particular issue and a dissenting vote is not required.

Still, we feel at times there can be too much reticence to vote against company management in order to protect relationships and perhaps to avoid being associated with an "activist approach." One example is nonroutine shareholder resolutions where some asset managers appear to have a strong default position of supporting company management. This may act as a barrier to change and send a false signal to other investors and peer companies about the issue in question.

Despite it being one of the tools available for stewardship, none of the asset managers in our sample have ever filed a shareholder resolution, although we understand one plans to do so in future.

Stock lending frequently occurs, but it is very rare to recall stock before a vote. This does not seem ideal as third parties may borrow stock with the intention of gaining voting power.

Collaboration
There are pockets of excellent collaboration across the industry, but collaboration among managers within our sample seems low. Large index managers are used to competing intensely for market share, but stewardship is an area where collaboration not competition is often in the clients' interests.

Only the three smaller managers in our sample are signatories of Climate Action 100+, the world's largest collaborative initiative around managing climate risk.

Leadership
The stewardship challenge calls for leadership-minded thinking and, particularly for large index managers, a universal owner mindset[11] could capture both the responsibility and opportunity. They could more proactively set out their investment beliefs and, consequently, the standards expected of companies across a range of issues including those raised in this brochure, and more.

The long and winding road ahead

Stewardship is an underappreciated but critical part of corporate oversight. It is showing encouraging momentum across the industry, and index managers are stepping up – with some good signs of progress. Still, there is a lot more to reach for, with structural challenges to cut through given highly-fragmented ownership interests.

For asset managers to put both hands firmly on the wheel, more of their clients and intermediaries need to pay close attention and call for a safe journey. Then there will be reason for optimism.

[6] Julia Finch, "Myners in veiled criticism of M&S over Rose's two roles," *The Guardian*, June 17, 2010, https://www.theguardian.com/business/2010/jun/18/myners-criticises-marks-and-spencer.

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