



# **Delegating Shareholder Engagement: Holding Fund Managers to Account**

LAPFF Trustee Guide  
October 2006

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The Local Authority Pension Fund Forum, which was set up in 1991, is a voluntary association of 39 public sector pension funds based in the UK. It exists ‘to promote the investment interests of local authority pension funds, and to maximise their influence as shareholders to promote corporate social responsibility and high standards of corporate governance amongst the companies in which they invest.’ The Forum’s members currently have combined assets of £70 billion.

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## Acknowledgements

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## Structure of Guide

Trustees can read this Guide in its entirety or, if they do not require a great deal of background information, refer to individual sections separately. For example, the introduction provides information on the regulatory background and the state of the debate on engagement, which the more experienced trustee may want to omit. The assessment criteria are set out in seven sections, in keeping with the ISC Principles:

- Principles on Activism (page 10)
- Policies on Engagement (page 12)
- Monitoring Companies (page 14)
- Company Intervention (page 16)
- Evaluation of Fund Managers’ Engagement (page 18)
- Reporting Engagement Activities (page 20)
- Reviewing Policy & Practice (page 22)

Each section sets out the responsibilities of funds and their fund managers, based on the Myners’ or ISC Principles and best practice considerations. This is then illustrated with an example of how a fund might attempt to discharge itself of the responsibility. This is followed by a set of assessment criteria in the form of questions, many of which require simple ‘yes/no’ answers.

For further explanation of the questions, the user can refer to the Appendix: the assessment criteria are collated in table format in the Appendix, where additional commentary for each question (where useful) is also provided. Acronyms and technical terms are explained in the glossary.

## Benefits for the Fund

The Guide has been written by PIRC, the Forum’s research and engagement partner, with due attention to the resource and time constraints that funds face. It will enable fund trustees and officers to conduct periodic reviews of their fund managers’ engagement activities, in order to:

- Enable the assessment of engagement progress along with quality and effectiveness
- Initiate a dialogue between funds and fund managers on engagement
- Develop a better understanding of practical aspects of their fund manager’s engagement activities
- Open up opportunities for improvements to current strategy, policy and practice
- Become more activist by identifying opportunities for funds to get involved
- Get the most out of fund managers’ engagement services.

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## Chapter 1 – Introduction

### Trustees as Active Shareholders

All pension funds are increasingly being asked to become more active owners of the companies in which they invest. Local authority pension funds are no different. The Local Authority Pension Fund Forum has long believed that trustees have an active role to play in promoting good practice in corporate governance (CG) and social, ethical and environmental (SEE) matters. An important way in which trustees can become more activist, even if resources may be limited, is by regularly reviewing their fund managers' engagement activities with a view to assessing the effectiveness of that engagement, on the basis of regular (e.g. quarterly) reports from fund managers or in meetings with them. Delegating shareholder engagement does not mean that trustees should simply let their fund managers takeover shareholder activism. Delegation still requires responsible stewardship by trustees of their managers' delegated responsibilities.

How can local authority pension fund trustees assess the quality and effectiveness of their fund managers' engagement? LAPFF published a Trustee Guide on Shareholder Engagement in 2005 to assist local authority pension fund trustees with this task, focusing on local authority pension funds' and fund managers' compliance with ISC and Myners' Principles.

The guidance was based in part on a postal survey with 55 local authority pension fund and nine fund manager respondents, and interviews with seven selected pension funds. Two reports on the survey and interview results were published in 2004.

The Forum's approach reviews both regular monitoring of companies to detect emerging concerns about risk and value destruction, as well as indicators directed towards measuring the effectiveness of a pension fund's engagement activities, thus providing an independent mechanism for assessing fund management practices, particularly when it comes to implementing the Myners' and ISC Principles.

## How to Use this Guide

This Trustee Guide aims to assist local authority pension fund trustees in the regular assessment of their fund managers' engagement strategies, policies and activities. It does this by setting out assessment criteria for all aspects of delegated shareholder engagement, and integrates, in this revised version, best practice matters. The Guide gives trustees an insight into the relevant issues for each aspect, and sets out pertinent questions to ask their fund managers (or themselves).

While it may be useful to address all criteria contained in this Guide when conducting the assessment for the first time, the Guide can be adapted to suit a fund's specific requirements: the first assessment will enable the identification of strengths, weaknesses, and areas of future focus, on the basis of which trustees can select a subset of the criteria that is particularly relevant to the fund's particular situation.

The assessment can be conducted on the basis of fund managers' regular (typically quarterly) client reporting, and can also be used as a selection tool at appointment stage. The benefits of this Guide to trustees will be found if they routinely submit their fund managers' reporting to a critical appraisal and ask questions wherever the information provided is not clear. An overall review, for example on an annual basis, will then reveal any progress made, as well as any requirement for specific changes to strategy, policy or practice.

## Chapter 2 – Background to the Trustee Guide

The Trustee Guide is based, inter alia, on interviews conducted with seven of the leading fund managers of UK local authority pension funds, and is published against the backdrop of:

- Discernible adaptation of the industry to the introduction of Myner's Principles<sup>1</sup> and principles set out by the *Institutional Shareholders Committee* (ISC Principles<sup>2</sup>). Adaptation, in relation to the ISC Principles, is somewhat more advanced amongst fund managers – evident in increased engagement and more willingness to be transparent on votes – than amongst pension funds, a majority of which have been found to rely on activism policies of their fund managers, without actually taking them into account when selecting the manager<sup>3</sup>.

### Box 1. Myner's Principles<sup>4</sup>

Paul Myner published a review of UK institutional investors' approaches to investment decisions in March 2001. It identified a lack of active engagement by fund managers with investee companies on behalf of institutional investors, and recommended that pension funds should include their approach to activism in their Statement of Investment Principles, and in the written mandate given to their fund managers<sup>5</sup>.

Moreover, the Myner's Review identified the "*duties of managers to intervene in companies – by voting or otherwise – where there is a reasonable expectation that doing so might raise the value of the investment.*" This principle was taken from the US Department of Labor Interpretative Bulletin<sup>6</sup>.

<sup>1</sup> Paul Myner, *Institutional Investment in the UK: A Review*, H.M. Treasury, March 2001

<sup>2</sup> Institutional Shareholders' Committee, *The Responsibilities of Institutional Shareholders and Agents – Statement of Principles (Updated)*, September 2005

<sup>3</sup> Department of Work and Pensions, *The Myner's Principles and occupational pension schemes*, Research Report No 213, 2004

<sup>4</sup> Paul Myner, *Institutional Investment in the UK: A Review*, H.M. Treasury, March 2001

<sup>5</sup> The ongoing review of the impact of the Myner's Principles suggested that going forward, local authority pension funds should make reference to the ISC Principles rather than the US Bulletin. The final decision on this has not been publicised to date.

<sup>6</sup> Interpretative bulletin relating to statements of investment policy, including proxy voting policy or guidelines, Code of Federal Regulations Table 29 Chapter XXV, 2509. 94-2, 1994.

- Uncertainty about the future of narrative reporting in the UK. The proposed statutory Operating and Financial Review (OFR) was withdrawn in January 2006, but the requirement for a mandatory Business Review in line with the EU Accounts Modernisation Directive was maintained. Under threat of legal action by Friends of the Earth, the Government agreed in an out-of-court settlement to widen the scope of its consultation on the Business Review, and also to include comments on non-financial issues that formed part of the OFR regulation. On 3 May, in response to this consultation, the Government announced a package of measures to support its overhaul of company law including: the explicit statutory purpose for the Business Review to inform members of the company and help them assess how the directors have performed their duty to promote the success of the company, and the requirement, for publicly quoted companies, to include information to the extent necessary on the main trends and factors likely to affect the future development of the business.

A number of issues emerge that can be considered critical to the success of the UK's particular type of shareholder activism, which tends to be delegated to fund managers:

- **Quality of engagement.** It is unclear whether current increased levels of engagement alone are leading to better CG practice amongst companies. Active engagement, in keeping with the use of the phrase in the 2001 Myners' Review, should be more than a series of meetings with companies at which "polite reservations" are expressed. It should be conducted with some persistence to be effective and result in active intervention.
- **Integration of CG and corporate social responsibility (CSR) issues into mainstream investment processes.** A review of the ISC Principles (Box 2) observed that there is a lack of integration<sup>7</sup>. This represents an impediment to the effectiveness of fund managers' engagement.

- **Link between good CG and CSR standards, and financial performance.** Current research to establish the relationship between good governance and financial performance is leading to new insights and evidence. Work is still required to identify how any such relationship can be harnessed to improve the effectiveness of shareholder engagement. In the absence of a consensus about the nature of such evidence, it is difficult to introduce quantification into the assessment of intervention effectiveness.
- **Fund manager transparency.** While reporting by fund managers to their clients is now common, some dissatisfaction over the contents of these reports exists. Some of this stems from the perceived lack of the kind of information in those reports that would enable trustees to make a judgement about the effectiveness of their fund managers' intervention activities.

Pension fund trustees have a responsibility to ensure that shareholder activism is conducted in a way that fulfils their responsibility towards their members. Moreover, with the publication of the LAPFF Trustee Guide they now have an opportunity to engage in a debate with their managers about best practice and move the debate forward for the future.

## Box 2. ISC Principles<sup>8</sup>

The Institutional Shareholders' Committee (ISC) set out a statement of principles for the responsibilities of institutional shareholders and their agents in an apparent reaction to the Government's consultation on the possibility of introducing a statutory duty in relation to shareholder activism (2002)<sup>9</sup>.

The Principles provide best practice guidelines for all aspects of activism, from monitoring and intervention to assessing the effectiveness of intervention and reporting to clients.

A review of this approach in September 2005 found that there was sufficient evidence for the positive impact the Principles are having on investor behaviour, and that no major changes to the Principles were therefore required.

## Chapter 3 – Principles on Activism

### 3.1 Responsibilities of Funds and their Fund Managers

Local authority pension fund trustees must implement the Myner's Principles on a 'comply or explain' basis. This currently entails the incorporation of the US Department of Labor Interpretative Bulletin into fund manager mandates, which requires 'the responsible fiduciary' to vote proxies and monitor and influence the management of companies if there is 'a reasonable expectation that activities...are likely to enhance the value of the plan's investment'<sup>10</sup>.

Fund managers' strategies and policies, on the other hand, are typically based on the ISC Principles rather than the Myner's Principles. Whatever the case, a fund manager's explicit strategy on intervention in companies should state:

- When engagement will occur
- How it will be undertaken
- Any criteria by which effectiveness of the engagement will be measured.

### 3.2 Example: Voting Strategy

<b>Strategy</b>	Voting relating to UK shares held by the fund
<b>When</b>	The fund commits to voting proxies at all AGM and EGM resolutions
<b>How</b>	The pension fund may decide that voting is conducted on the basis of the fund manager's voting guidelines rather than on the basis of the fund's own voting guidelines
<b>Measurement criteria</b>	In order to measure the impact of the fund's vote, the fund may opt to apply a number of criteria, for example: <ul style="list-style-type: none"> <li>• Comparison of the fund's votes against meeting results</li> <li>• Changes in corporate policy and practice relating to issues of concern that triggered an oppose or abstain vote</li> <li>• Comparison of the fund's votes against industry votes (e.g. against ABI, LAPFF, NAPF or PIRC voting recommendations)</li> </ul>

### 3.3 Key Questions to Ask Your Fund Manager or Yourself

<b>3.1.a</b>	Is the fund's and/or fund manager's strategy on intervention clear?
<b>3.1.b</b>	If not, what needs to be done to bring it into conformity or explain any non-compliance in the Statement of Investment Principles?
<b>3.2</b>	Does the formal integration of CG and CSR aspects into the mainstream investment process form part of the fund manager's strategy?
<b>3.3</b>	Is the fund manager's strategy about the protection of value or about the enhancement of value?
<b>3.4.a</b>	Are the criteria for judging the effectiveness of the fund manager's engagement satisfactory?
<b>3.4.b</b>	If not, what criteria do the Fund and/or its fund managers propose to adopt?

<sup>10</sup>Interpretative bulletin relating to statements of investment policy, including proxy voting policy or guidelines, Code of Federal Regulations Table 29 Chapter XXV, 2509. 94-2, 1994.

## Chapter 4 – Policies on Engagement

### 4.1 Responsibilities of Funds and their Fund Managers

Whether funds adopt their own shareholder engagement policies, or those of the fund manager to whom they delegate the engagement, the following should be addressed in a public policy statement:

- How companies will be monitored
- Policy for requiring companies' compliance with the Combined Code
- Policy for meeting with a company's board and senior management
- How conflicts of interests of the fund manager (or the pension fund) will be minimised or dealt with
- Circumstances that will lead to engagement and the types of action that may be taken
- Decision-making process leading to engagement
- Circumstances leading to escalation/types of escalation
- Policy on voting

Funds and their fund managers should agree by whom these responsibilities are to be discharged, and arrangements for agents to report back.

### 4.2 Example: Engagement Policy and Responsibility

<b>Policy</b>	The fund adopts the fund managers' policies on engagement. These policies set out a number of circumstances when the fund manager will intervene, such as non-compliance with the Combined Code or other serious CG or CSR concerns.
<b>Responsibility</b>	The fund may decide that its fund manager is responsible for all engagement activities, and the monitoring that leads to them. However, the fund may opt for active engagement itself, for example jointly with other funds.
<b>Reporting arrangements</b>	The fund manager provides regular (e.g. quarterly) reports on its engagement activities to the fund.

### 4.3 Key Questions to Ask Your Fund Manager or Yourself

<b>4.1.a</b>	Have the fund and its fund managers agreed by whom the engagement responsibilities are to be discharged, and on arrangements for the fund managers to report back?
<b>4.1.b</b>	If so, do the trustees know which individual within each fund manager is responsible for implementation of the engagement policy?
<b>4.1.c</b>	Does the fund manager have a training policy in place according to which CG/CSR training needs of fund managers and analysts are regularly reviewed and acted upon?
<b>4.2.a</b>	Has the fund delegated responsibilities to more than one fund manager?
<b>4.2.b</b>	If so, what steps are trustees taking to ensure that each fund manager votes the fund shares in the same way and not against each other?
<b>4.3</b>	Does the fund manager recall lent stocks for the purpose of voting?

## Chapter 5 – Monitoring Companies

### 5.1 Responsibilities of Funds and their Fund Managers

The aim of monitoring, as defined in the ISC Principles, is to identify problems at companies at an early stage. This can be based on the analysis of company publications, such as annual reports and accounts, or through attendance at company meetings.

As part of this monitoring, the ISC Principles recommend that funds or their fund managers should:

- Satisfy themselves, to the extent possible, that the company’s board and sub-committee structures are effective, and that independent directors provide adequate oversight
- Maintain a clear audit trail, e.g. records of private meetings with companies, of votes cast, and of reasons for voting against the company’s management, for abstaining, or for voting with management in a contentious situation.

### 5.2 Example: Monitoring Systems

<b>Aim</b>	To provide the fund with information on issues of concern well in advance of AGMs and EGMs, for example in the form of ‘alerts’.
<b>Research provider</b>	The fund charges its fund manager(s) to conduct monitoring and take appropriate action (by voting or entering a dialogue with companies on issues of concern). However, the fund obtains additional information from third party research providers in the form of alerts.
<b>Use of monitoring results</b>	The information on companies collected by the fund manager(s) should be assessed against the fund’s (or fund manager’s) criteria for evaluating engagement impact and quality. The information contained in alerts can be complementary to the monitoring carried out by fund managers, and is thought to enhance the debate between trustees and fund managers.
<b>Use of audit trail</b>	The fund may use the audit trail for example to ensure consistency of engagement activities with engagement policy, or to identify any instances of conflicting votes cast by the fund’s different fund managers (on the same resolution at the same AGM or EGM)

### 5.3 Key Questions to Ask Your Fund Manager or Yourself

<b>5.1</b>	Does the fund manager conduct systematic monitoring of CG and CSR issues at companies?
<b>5.2</b>	Is the monitoring conducted by a dedicated CG/CSR team or by financial analysts?
<b>5.3.a</b>	Is the monitoring of companies (with the view to outcomes of the fund’s engagement strategy) producing relevant information in a form that enables the assessment of the strategy’s effectiveness?
<b>5.3.b</b>	If not, is this matter best resolved directly with the fund manager and/or research providers concerned, or through investor bodies?

## Chapter 6 – Company Intervention

### 6.1 Responsibilities of Funds and their Fund Managers

Engagement, as set out in the ISC Principles, is about exercising votes and, where necessary, intervening with companies in an informed way. Moreover, where it would make intervention more effective, investors should seek to engage with other shareholders. Escalation of action should be decided case-by-case. According to the Myners' Principles, intervention should take place if there is a reasonable expectation that this may raise a fund's investment value.

### 6.2 Example: 'Comply or Explain' Approach

<b>Trigger</b>	An oppose vote on a specific resolution may be triggered by circumstances determined in the fund manager's policy, adopted by the fund (e.g. non-compliance with Combined Code).
<b>Action</b>	The fund manager may choose to amend this vote to support the company's board as a result of an explanation provided by the board that is considered satisfactory. This may in turn enable dialogue with the company in question.
<b>Conflict of interest</b>	The fund needs to ensure that the fund manager's actions have not been influenced by a conflict of interest. Where genuine limitations to effective engagement exist, the fund may opt to become active itself, potentially overriding the fund manager's voting outcome, or employing more high profile action.

### 6.3 Key Questions to Ask Your Fund Manager or Yourself

<b>6.1.a</b>	Does engagement take place in predetermined circumstances?
<b>6.1.b</b>	If not, is it clear from the report what the rationale for intervention was in each case and which criteria are used to measure engagement effectiveness?

<b>6.1.c</b>	Is there a formal decision-making process prior to engagement?
<b>6.2.a</b>	Do the fund and/or its fund managers have an escalation strategy if a company does not respond constructively to concerns?
<b>6.2.b</b>	If not, is the issue of sufficient concern to be raised through investor bodies?
<b>6.2.c</b>	Does the report contain information on cases of 'comply/explain'?
<b>6.3.a</b>	Is there any evidence in the report or from other sources that the fund manager has a conflict of interest, which may limit engagement due to commercial or other relationships between the fund manager and target companies?
<b>6.3.b</b>	If so, would co-operation through investor bodies offer a possible solution to the problem?
<b>6.4</b>	How does the fund manager arrive at its default vote?

# Chapter 7 – Evaluation of Fund Managers’ Engagement

## 7.1 Responsibilities of Funds and their Fund Managers

The ISC Principles require that fund managers, as the agents of pension funds, should “set out the circumstances when they will actively intervene and how they propose to measure the effectiveness of doing so”.

While the Principles do not define effectiveness any further, the ISC has, in its review of the Principles, announced the establishment of a working group that will “compare experiences and draw conclusions about the usefulness of particular approaches and the effectiveness of engagement”. Findings from previous, regular assessment of engagement activities delegated to fund managers will support this process.

## 7.2 Example: Engagement Evaluation Process

<b>Choice of criteria</b>	The fund adopts a subset of the criteria set out in this LAPFF Trustee Guide as its fund-specific evaluation criteria. These could be aimed, for example, at identifying <ul style="list-style-type: none"> <li>• Whether generally accepted CG or CSR standards are reflected in the fund manager’s engagement policies</li> <li>• The degree to which the fund manager adheres to voting policies</li> <li>• Changes in corporate policies and practices that demonstrate engagement impact</li> <li>• Potential follow-up activities that the fund could usefully undertake (such as engagement activities or changes to fund policy)</li> </ul>
<b>Action</b>	The fund conducts a regular assessment of its fund managers’ engagement reports, for example on a quarterly basis. The findings are then reviewed periodically (e.g. annually) to identify trends and areas for improvement.
<b>Information source</b>	The assessment will be based on a number of sources: <ul style="list-style-type: none"> <li>• The fund’s regular assessment of fund manager reports</li> <li>• Monitoring results in a form that is relevant to the fund’s assessment criteria</li> </ul>

<b>Information source</b>	<ul style="list-style-type: none"> <li>• Feedback from shareholders and other stakeholders on specific cases of engagement</li> <li>• Disclosure of the votes cast by the fund manager (e.g. annually)</li> </ul>
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## 7.3 Key Questions to Ask Your Fund Manager or Yourself

<b>7.1.a</b>	Is there evidence of improvements in the rigour with which qualitative and/or quantitative evaluations of engagement activities are undertaken?
<b>7.1.b</b>	If not, would co-operation through investor bodies to discuss areas for improvement be helpful to the fund?
<b>7.2</b>	Does the fund manager routinely review monitoring results post-engagement in order to identify changes or progress at companies?
<b>7.3</b>	Does the fund manager conduct an internal audit to check whether votes cast actually reach the company?
<b>7.4</b>	Does the fund manager conduct an internal audit of voting outcomes against voting policies?
<b>7.5</b>	Does the fund manager set specific objectives for engagement, and measure engagement success or failure against those objectives?
<b>7.6</b>	Does the fund manager disclose incidents where engagement has been discontinued or abandoned, and explain the reasons for this outcome?

## Chapter 8 – Reporting Engagement Activities

### 8.1 Responsibilities of Funds and their Fund Managers

“Transparency is an important feature of effective shareholder activism. Institutional shareholders and agents should not however be expected to make disclosures that might be counterproductive. Confidentiality in specific situations may well be crucial to achieving a positive outcome.”  
(ISC Principles)

Fund managers typically fulfill the transparency requirement by providing clients with sections on engagement in their quarterly reports. The information provided should include a judgement on the impact and effectiveness of their engagement.

### 8.2 Example: Reporting Arrangements

<b>Report format and content</b>	The fund receives regular reports from its fund manager that are not specific to the fund. If the fund requires additional information or a specific data format in order to enable a full assessment of the fund manager’s engagement effectiveness, the fund manager will most likely be unable to provide it, as it would mean changes to the report content for all its clients.
<b>Individual agreements</b>	The particular information reported, including the format in which details of how votes have been cast will be presented, is a matter for agreement between the pension fund and its fund manager. The scope to make changes to report content upon request from individual clients, however, may be limited by the fact that many fund managers produce one report for all clients, that reports on their activities are often subject to strict editorial limits, and that responsibilities for reporting policy and client feedback are often with separate departments, and not with the CG department. A joint approach by a number of investors may well help to overcome these obstacles to better reporting.

<b>Action</b>	The fund may consider joint action with other local authority pension funds (for example via LAPFF) to negotiate content or format changes with the fund manager.
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### 8.3 Key Questions to Ask Your Fund Manager or Yourself

<b>8.1</b>	Would the fund find it useful to receive confidential information on cases of intervention in progress, if this does not happen already?
<b>8.2</b>	Does the fund manager’s report provide a sense of progress in terms of CG/CSR good practice?
<b>8.3</b>	Does the report contain information on cases of ‘comply/explain’?
<b>8.4.a</b>	Is the content of the report overall satisfactory for evaluating the success of the fund’s engagement strategy?
<b>8.4.b</b>	If not, is the fund manager willing to accommodate changes to their report, to enable the fund’s assessment of engagement activities?
<b>8.4.c</b>	Is the report client-specific?
<b>8.4.d</b>	If not, would co-operation through investor bodies to discuss areas for improvement be helpful to the fund?

## Chapter 9 – Reviewing Policy & Practice

### 9.1 Responsibilities of Funds and their Fund Managers

Individual funds should review on a regular basis their progress against objectives that were agreed at the outset, in order to identify areas where improvement of strategy, policies and practices is still necessary.

### 9.2 Example: Review of Intervention Strategy

<b>Review</b>	Fund conducts a review of its intervention strategy, between one to three years after adoption, against criteria for judging outcomes that were originally agreed. The review can be based on the outcomes of the regular assessment of fund managers' engagement activities, but should also take into account other factors, for example regulatory developments, or outcomes from joint engagement or the ongoing debate with other investors.
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### 9.3 Key Questions to Ask Yourself

<b>9.1</b>	Does the fund require fundamental changes to its engagement strategy, policy or practice?
<b>9.2.a</b>	Does the fund require fundamental changes to the way its fund manager conducts its monitoring and engagement activities, and reports on them?
<b>9.2.b</b>	If yes, are these changes best achieved by negotiating directly with the fund manager, or are there common issues with other funds that could be addressed jointly, for example through investor bodies, and by taking part in a wider debate?

## Appendix Summary Table with Commentary Principles on Activism

Responsibilities	Questions	Commentary
Intervention strategy: When, how, and criteria for measuring effectiveness	<b>3.1.a</b> Is the fund's and/or fund manager's strategy on intervention clear?	Is it clear when engagement will occur, how it will be undertaken, and what criteria will be used to assess the effectiveness of engagement activities?
	<b>3.1.b</b> If not, what needs to be done to bring it into conformity or explain any non-compliance in the Statement of Investment Principles?	
	<b>3.2</b> Does the formal integration of CG and CSR aspects into the mainstream investment process form part of the fund manager's strategy?	The degree to which integration is successful depends on whether it is more than superficial, i.e. whether it relies mainly on informal communication between fund managers and financial analysts on one side and CG or CSR specialists on the other side, or whether this is supported by more formalised approaches, for example by way of committees consisting of senior personnel from both sides that have ultimate responsibility for engagement decisions.
	<b>3.3</b> Is the fund manager's strategy about the protection of value or about the enhancement of value?	While it is in the interest of shareholders that fund managers act as gatekeepers against major issues that could potentially be value-destroying, they may not commit enough time or energy to best practice issues that could enhance a company's CG or CSR performance and hence the fund's value in the long-term.
	<b>3.4.a</b> Are the criteria for judging the effectiveness of the fund manager's engagement satisfactory?	This question does not apply if criteria have not been set out.
	<b>3.4.b</b> If not, what criteria do the Fund and/or its fund managers propose to adopt?	The debate on how to assess engagement effectiveness is ongoing, and funds are unlikely to have a ready-made list of criteria at hand. LAPFF is continuing to work on the matter of effectiveness, as does the ISC, which is setting up a work group on the subject.

## Policies on Engagement

Responsibilities	Questions	Commentary
<ul style="list-style-type: none"> <li>How companies will be monitored</li> <li>Policy for compliance with Combined Code</li> <li>Policy on company meetings</li> <li>Managing conflicts of interest</li> <li>Intervention triggers/types</li> <li>Escalation triggers/types</li> <li>Decision on engagement</li> <li>Voting policy</li> </ul>	<b>4.1.a</b> Have the fund and its fund managers agreed by whom the engagement responsibilities are to be discharged, and on arrangements for the fund managers to report back?	Funds have little capacity to carry out monitoring or engagement themselves. More often than not funds outsource monitoring and engagement to fund managers (64% of funds <sup>11</sup> ). However, 44% funds also conduct engagement themselves.
	<b>4.1.b</b> If so, do the trustees know which individual within each fund manager is responsible for implementation of engagement policy?	
	<b>4.1.c</b> Does the fund manager have a training policy in place according to which CG/CSR training needs of fund managers and analysts are regularly reviewed and acted upon?	The investment decision-making power ultimately lies with the investment team, and in many cases, monitoring of CG/CSR issues is conducted by financial analysts. If fund managers and financial analysts receive only impromptu, informal training on CG/CSR issues, especially if there is no CG team that puts checks and balances in place, it casts doubt on their ability to fulfil the role of an early warning system.
	<b>4.2.a</b> Has the fund delegated responsibilities to more than one fund manager?	
	<b>4.2.b</b> If so, what steps are trustees taking to ensure that each fund manager votes the fund's shares in the same way and not against each other?	Funds sometimes find that their different fund managers are voting against each other. This probably correlates with a tendency to apply a case-by-case rather than a systematic approach to engagement. In accordance with the Myners' Principles "trustees should also ensure that managers have an explicit strategy elucidating the circumstances in which they will intervene in a company". Trustees would then be aware of conflicts between the strategies of their different fund managers, and be able to set out ways of dealing with them.
<b>4.3</b> Does the fund manager recall lent stocks for the purpose of voting?	Recalling lent stocks in advance of AGMs or EGMs is necessary to employ the fund's full voting power.	

## Monitoring Companies

Responsibilities	Questions	Commentary
<ul style="list-style-type: none"> <li>Identifying problems at companies</li> <li>Monitoring board structures</li> <li>Maintaining audit trail of meetings, voting etc.</li> </ul>	<b>5.1</b> Does the fund manager conduct systematic monitoring of CG and CSR issues at investee companies?	Local authority pension fund trustees should question their fund managers about whether they have the rigorous monitoring systems and procedures in place that are necessary to identify not only issues that could be value-destroying in the short-term, but also concerns about a company's long-term performance and opportunities to enhance value.
	<b>5.2</b> Is the monitoring conducted by a dedicated CG/CSR team or by financial analysts?	Monitoring conducted by financial analysts can be a sign of integration into mainstream investment processes, but it can also mean a shift from value-enhancement to value-protection. Without proper training on CG and CSR, it is also questionable if financial analysts will be able to ask pertinent questions.
	<b>5.3.a</b> Is the monitoring of companies (with the view to outcomes of the fund's engagement strategy) producing relevant information in a form that enables the assessment of the strategy's effectiveness?	The review of fund managers monitoring results should underpin the evaluation of effectiveness of their engagement activities (and hence of the fund's engagement strategy insofar as its implementation is outsourced). This requires a systematic approach that includes, for example, maintaining and reviewing audit trails.
	<b>5.3.b</b> If not, is this matter best resolved directly with the fund manager and/or research providers concerned, or through investor bodies?	

## Company Intervention

Responsibilities	Questions	Commentary
<ul style="list-style-type: none"> <li>Determining intervention triggers</li> <li>Measuring effectiveness</li> <li>Maintaining audit trail of meetings, voting etc.</li> </ul>	<b>6.1.a</b> Does engagement take place on predetermined circumstances?	If fund managers make the decision whether engagement should take place on a case-by-case basis, and rely on subjective assessment and professional experience of individuals, the views of these individuals on what constitutes a serious CG issue will influence the decision-making. There is evidence of views that distinguish between value-destroying CG issues (e.g. Mergers and Acquisitions) and 'other' CG issues, and a clear inclination to act on the former rather than the latter.
	<b>6.1.b</b> If not, is it clear from the report what the rationale for intervention was in each case and which criteria are used to measure engagement effectiveness?	
	<b>6.1.c</b> Is there a formal decision-making process prior to engagement?	Funds should ask who has got the decision-making power, and how fund managers arrive at the decision to engage. It is important to establish the seniority level of staff involved, or the existence of CG/CSR committees with senior managerial staff from both financial and CG/CSR teams of the fund manager.
	<b>6.2.a</b> Do the Fund and/or its fund managers have an escalation strategy if a company does not respond constructively to concerns?	LAPFF research found fund managers to be reluctant to opt for high profile or public intervention, such as involving the media or tabling a resolution. Oppose votes may be seen as drastic action, and a ' <i>comply or explain</i> ' approach is often applied in conjunction. There is greater support for collaboration with other shareholders.

## Company Intervention (continued)

Responsibilities	Questions	Commentary
	<b>6.2.b</b> If not, is the issue of sufficient concern to be raised through investor bodies?	
	<b>6.2.c</b> Does the report contain information on cases of 'comply/explain'?	The ' <i>comply or explain</i> ' approach gives the company the opportunity to make certain commitments or promises, or give explanations on why best practice is not in place. Pension fund trustees need to know what response fund managers have made to such instances.
	<b>6.3.a</b> Is there any evidence in the report or from other sources that the fund manager has a conflict of interest, which may limit engagement due to commercial or other relationships between the fund manager and target companies?	Pension fund trustees should require an adequate policy and systems at their fund managers to disclose and manage conflicts of interest.
	<b>6.3.b</b> If so, would co-operation through investor bodies offer a possible solution to the problem?	
	<b>6.4</b> How does the fund manager arrive at its default vote?	The ISC Principles state that fund managers should not support management by default; however, resource constraints may mean that the fund manager can not review every company's AGM or EGM; in this case, external voting advice should be sought.

## Evaluation of Fund Managers' Engagement

Responsibilities	Questions	Commentary
Mechanisms for monitoring and assessing results of engagement	<b>7.1.a</b> Is there evidence of improvements in the rigour with which qualitative and/or quantitative evaluations of engagement activities are undertaken?	The evaluation of engagement activities is an area of development, and fund managers may well develop evaluation techniques.
	<b>7.1.b</b> If so, would co-operation through investor bodies to discuss areas for improvement be helpful to the fund?	
	<b>7.2</b> Does the fund manager routinely review monitoring results post-engagement in order to identify changes or progress at companies?	Fund managers should be expected to revisit companies post-engagement in order to assess any progress made against the engagement objective; a systematic approach to monitoring is a prerequisite to this.
	<b>7.3</b> Does the fund manager conduct an internal audit to check whether votes cast actually reach the company?	Trustees may want to know the outcome of any internal audit that has been carried out, with a view to identifying any missing votes.
	<b>7.4</b> Does the fund manager conduct an internal audit of voting outcomes against voting policies?	Trustees should ask their fund manager how they ensure that votes cast follow the correct policy, and how they arrive at their default vote (the ISC Principles state that fund managers should not support management by default).
	<b>7.5</b> Does the fund manager set specific objectives for engagement, and measure engagement success or failure against those objectives?	If fund managers are reluctant to set specific objectives for their engagement with companies, it is difficult to define success or failure and thus the effectiveness of engagement.
	<b>7.6</b> Does the fund manager disclose incidents where engagement has been discontinued or abandoned, and explain the reasons for this outcome?	Pension fund trustees need to be aware of incidents of engagement discontinuance. This helps funds to assess successful strategies by managers, and their 'activist tolerance', i.e. their preparedness to pursue engagement in a high profile and more aggressive way, as well as potential engagement escalation by pension fund trustees themselves.

## Reporting Engagement Activities

Responsibilities	Questions	Commentary
Transparent reporting on outcomes of engagement	<b>8.1</b> Would the fund find it useful to receive confidential information on cases of intervention in progress, if this does not happen already?	
	<b>8.2</b> Does the fund manager's report provide a sense of progress in terms of CG/CSR good practice?	The report should put into context a specific intervention, e.g. have issues been raised repeatedly in the past; is there a sense of persistence on the part of the fund manager, and evidence that engagement is active, i.e. goes beyond merely meeting companies and politely expressing concerns.
	<b>8.3</b> Does the report contain information on cases of 'comply/explain'?	The 'comply or explain' approach gives the company the opportunity to make certain commitments or promises, or give explanations on why best practice is not in place. Pension fund trustees need to know what response fund managers have made to such instances.
	<b>8.4.a</b> Is the content of the report overall satisfactory for evaluating the success of the fund's engagement strategy?	
	<b>8.4.b</b> If not, is the fund manager willing to accommodate changes to their report, to enable the fund's assessment of engagement activities?	
	<b>8.4.c</b> Is the report client-specific?	If the report is not client-specific, pension funds may well receive information on engagement with companies that they do not invest in. It also makes any requests for changes to reporting content less likely to succeed.
	<b>8.4.d</b> If not, would co-operation through investor bodies to discuss areas for improvement be helpful to the fund?	

## Reviewing Policy and Practice

Responsibilities	Questions	Commentary
Funds to regularly review their progress against objectives that were agreed at the outset, in order to identify areas where improvement of strategy, policies and practices is still necessary	<b>9.1</b> Does the fund require fundamental changes to its engagement strategy, policy or practice?	
	<b>9.2.a</b> Does the fund require fundamental changes to the way its fund manager conducts its monitoring and engagement activities, and reports on them?	
	<b>9.2.b</b> If yes, are these changes best achieved by negotiating directly with the fund manager, or are there common issues with other funds that could be addressed jointly, for example through investor bodies, and by taking part in a wider debate?	

## Glossary

- Business Review** Statutory requirement for listed companies to publish a Business Review in their directors’ report, with the explicit statutory purpose to inform members of the company and help them assess how the directors have performed their duty to promote the success of the company, and the requirement, for publicly quoted companies, to include information to the extent necessary on the main trends and factors likely to affect the future development of the business.
- Combined Code** Under the Listing Rules UK companies are required to make a statement on how the company has complied with the Combined Code principles of best practice in CG; make a compliance statement specifying the Code provisions with which the company has not complied; and state whether the board considers that the company has complied with the Code in full during the whole period under review.
- ‘Comply or explain’ approach** Combination of dialogue with companies and voting, by which a company is informed of an intended voting outcome, which is then amended in case of successful engagement with the company.
- Engagement** Institutional shareholders can fulfil their ownership duties in several ways: Voting, i.e. using shareholder voting rights at AGMs or EGMs; entering a dialogue with a company on issues of concern; or the ‘comply or explain approach’ (see above)

<b>Institutional Shareholders Committee (ISC)</b>	The Institutional Shareholders’ Committee issued ‘The Responsibilities of Institutional Shareholders and Agents – Statement of Principles’ in October 2002. In 2002, the members of the ISC were: the Association of British Insurers; the Association of Investment Trust Companies; the National Association of Pension Funds; and the Investment Management Association.
<b>Investor bodies</b>	For the purpose of this report: Association of British Insurers (ABI), Local Authority Pension Fund Forum (LAPFF), National Association of Pension Funds (NAPF) and PIRC.
<b>Myners’ Principles</b>	Paul Myners recommended pension fund trustees voluntarily adopt, on a ‘ <i>comply or explain</i> ’ basis a series of principles codifying best practice for decision-making in relation to investment.
<b>Operating and Financial Review (OFR)</b>	An OFR ‘is a narrative explanation, provided in the annual report, of the main trends and factors underlying the development, performance and position of an entity during the period covered by the financial statements, and which are likely to affect the entity’s future development, performance and position.’ There is no longer a statutory requirement for companies to provide an OFR. (See also: <b>Business Review</b> )
<b>Proxy voting</b>	Exercising shareholder voting rights at AGMs or EGMs by appointing proxies and submitting voting instructions which may be implemented, often only if a poll is called.

<b>Statement of Investment Principles (SIP)</b>	Written statement of the principles governing a fund’s decisions about investments, which the administering authority is required, by law, to prepare, maintain and publish (after consultation). Must cover their policy on, inter alia, the extent (if at all) to which social, environmental or ethical considerations are taken into account in the selection, retention and realisation of investments; and also the exercise of rights (including voting rights) attaching to investments, if they have such a policy.
<b>US Pension Fund intervention strategies</b>	The Myners’ Review believes that the US Department of Labor Interpretative Bulletin correctly articulates the duty of care, which fund managers owe clients to pursue effective intervention, such as proxy voting, where it might add value to the Fund.
<b>Voting proxies</b>	See: Proxy voting





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