The five pillars of effective stewardship
With a systemic stewardship focus
About this report

This report is complementary to work done by TAI, on behalf of PRI, as part of the stewardship resourcing project.

In this report, we will cover:

- Overview of stewardship
- The five pillars of effective stewardship
- Way forward and calls to action

Please click below to access reports from the TAI/PRI stewardship resourcing project:

Main report: “Putting resources where stewardship ambitions are”

Two supporting documents: the “Stewardship Resources Assessment Framework” and the “Global Stewardship Resourcing Survey data report”.

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Overview of stewardship in the investment industry

TAI perspective

1. Increased stewardship resourcing
2. Engaged AO-AM relationship
3. Integrated stewardship approach
4. Coalition stewardship approach
5. Systemic stewardship focus

Way forward

Investee and issuer stewardship
Engaging with current or potential investees/issuers, across all asset classes, voting at shareholder meetings, filing shareholder resolutions/proposals, fulfilling direct roles on investee boards and board committees and litigating.

Systemic stewardship
Engaging with policy makers/standard setters, contributing to public goods (e.g. research), engaging in public discourse and disclosures that support stewardship goals, negotiating with, and monitoring others in the investment chain (e.g. asset owners engaging with investment managers).

Engagement
An investor (or an engagement service provider) communicating with current or potential investees/issuers (such as companies), to improve ESG practices, sustainability outcomes or public disclosure.

3D investing
3D investing considers risk, return alongside impact, and applies stewardship to the management of systemic risks. Outcomes often seen as improvements in the market return or ‘beta’ whereas issuer-level stewardship produces outcomes in the individual issuer performance or ‘alpha’.
Pillars of effective stewardship

1. Increased stewardship resourcing
   - Stewardship resourcing needs to double at the industry level, but no one-size-fits-all for each organisation
   - More measurement through a structured approach

2. Engaged AO-AM relationship
   - Builds more disciplined accountability into the relationship
   - Supports a new target

3. Integrated stewardship approach
   - Supports more joined-up stewardship
   - Can enable a cost neutral increase in resourcing

4. Coalition stewardship approaches
   - Stronger stewardship proposition from collaborative approaches
   - Use of coalition organisations to facilitate

5. Systemic stewardship focus
   - Addressing systemic risk issues
   - Can be approached through coalition organisations
The global trend in ESG and stewardship regulation is that expectations are rising, albeit with regional differences. There has been an increase in reporting expectations.

- Escalating stakeholder interest, media coverage, and NGO influence add further pressure on stewardship resources and on resourcing as an issue.

- The investment industry faces multifaceted challenges arising from the emergence of systemic risks like climate change, biodiversity loss, or antimicrobial resistance.

- Addressing evolving risks requires a more impactful stewardship approach spanning issuer-specific engagement, industry-wide initiatives and policy engagement.

- Stronger collaboration is important in stewardship efforts. It can optimise industry resources more efficiently and leverage collective strengths.

- Stewardship activities have expanded beyond listed equities to encompass other asset classes. Some of these asset classes and/or issuers are complex to engage – e.g. sovereigns, or state-owned enterprises.

- Achieving meaningful impact through engagement requires expertise and persistence. Engagements are becoming more complex as engagement emphasis shifts from disclosure to action.
Adopting a structured measurement approach

Six key figures

a. Costs of stewardship specialists (or FTE)

b. Costs of other investment professionals conducting stewardship activities (or FTE)

c. AO only: costs of delegation of stewardship activities to AMs (or FTE)

d. Costs of specialist 3rd party providers of stewardship services (or FTE)

e. Costs of reporting and client services for communicating stewardship activities (or FTE)

F. Estimating stewardship-related resources as a percentage of investment management spend

Six key points of context

G. Type (asset owner, asset manager)

H. Ambition and commitment

I. Size

J. Asset mix

K. Inhouse vs outsourced stewardship

L. Regional orientation
An engaged AO-AM relationship
Click to access The Stewardship Resources Assessment Framework

Asset owners request asset managers to complete the framework questionnaire

Asset managers provide the estimate of their stewardship resource level

Engage in productive conversations, supported with findings and guidance from the framework

Source: TAI/PRI Stewardship resourcing report: Putting resources where stewardship ambitions are
Greater use of integrated stewardship approaches

- Reassessing and reallocating: **asset allocation → stewardship**
  
  *For example, portfolio managers responsible for allocation decisions might take a larger role in the stewardship activities*

- It may be a cost-effective way to deploy extra stewardship resources, offering a cost neutral route

- The following are supportive to investment professionals carrying out stewardship activities under the integrated approach
  - sufficient training
  - a clear mandate to carry out stewardship activities
  - effective ways of working with specialist stewardship colleagues
  - access to relevant data, specialist resources and tools
  - working within an investment model that recognises the value of stewardship to the whole portfolio
  - incentives or recognition for stewardship efforts
Stronger and better collaboration is essential

Benefits
- Especially beneficial for smaller asset owners or managers lacking resources
- Optimising limited resources and leveraging collective strengths
- A consolidation and prioritisation process:
  - ensuring that efforts align with the most critical issues at hand
  - maximising the effectiveness of stewardship actions within the available resource constraints

Example of collaborative efforts: Church of England and the Investor Mining and Tailings Initiative

In light of the tragic collapse of a Vale tailings dam in Brazil in 2019, a $1.3 trillion coalition of asset owners, led by the Church of England Pension Board together with Church Commissioners for England, and Sweden’s Public Pension Funds Council on Ethics demanded stringent safety policies in the mining industry. This coalition proposed a new global safety classification system independent of companies, focusing on ensuring the security of mining companies’ tailings dams—structures that contain hazardous byproducts from mining operations. This coalition's efforts to improve safety standards in the mining industry exemplify the power of collaborative stewardship and demonstrate how investors can achieve significant progress through collective action.

In 2022, the Church of England Pensions Board, along with other members of the initiative became part of the Steering Committee of the Global Investor Commission on Mining 2030, a collaborative investor-led initiative seeking to define a vision for a socially and environmentally responsible mining sector overall by 2030.

Considerations
- Strategic choice between insourcing and outsourcing capabilities: what's best performed internally versus tapping into external expertise or platforms
- 'Optimising' strategies has difficulties because the costs and the value added are very soft
- Collaborations may be suboptimal
- Caution is necessary regarding antitrust concerns, particularly in the US
Stewardship and systemic risk

Effective stewardship recognises that systemic risk must be managed:

- Systemic risks are critical to the sustainability and resilience of the financial system, and therefore instrumental to investors’ financial outcomes.
- One of the greatest threats to the long-term returns of diversified investors comes from the trillions of dollars in social and environmental costs businesses externalise annually.
- At a minimum, institutional investors should be open to the possibility that beta considerations can enter into proxy voting decisions.

Universal owners provide a natural base of investors who can understand and manage their private systemic risk through their investment strategy but also play a more influential public role in safeguarding the financial system and contributing positively to big societal and environmental issues working from aligned interests.
System stewardship tools
Certain elements are essential to system stewardship

- System stewardship
  - Legal foundation
    - e.g. Freshfields Report
  - Economic principles
    - e.g. allocate resources in new ways
  - Internal policies
    - e.g. shift in ambition
  - Stewardship practices
    - e.g. move towards macro stewardship
  - External mandates
    - e.g. change mandates to authorise practice

- Freshfields report: shows investment professionals around the world have an obligation to prioritise systemic issues (e.g. climate change) over financial performance of individual companies when they provide greater risk to portfolios

- The Cambridge Principles: e.g. Universal owners can most effectively protect their portfolios by working with others to steward companies away from cost externalisation

Source:
Shareholder Commons
PRI/Freshfields report: Legal Framework for Impact

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Systemic stewardship is crucial to our Net Zero/ climate effort

Effective engagement plays a vital role in the pathway to net zero
- Aligning investments with net zero goals
- Influencing capital allocation
- Mitigations of climate related risks
- Driving transparency and accountability regarding companies’ climate footprint and decarbonisation plans
- Supporting innovative climate solutions
- Fostering systemic change

The Net-Zero Asset Owner Alliance report, The Future of Investor Engagement, called for systemic stewardship and broad stakeholder involvement to address systemic climate risks. This includes:
- expanding sector engagement
- enhancing investor expertise for policy engagement
- providing guidance for aligning asset owners' interests with portfolio management through asset manager engagement.
Universal ownership

Increasing numbers of asset owners self-declare as universal owners with ambition to undertake systemic stewardship

- Universal owners are large long-term holders of index-like portfolios that are exposed to the entire market and economy.

- Universal owners also own a significant slice of corporate externalities which risk being internalised to their funds’ net cost, now or in the future.

- Universal owners are leadership-minded to grow the value and utility of their wealth by managing their long-term inter-dependencies across the portfolio over time.

- Categorisation of universal owners follows from a combination of their characteristics, actions and mindset.

- The challenge for UO’s is hyper-integrated* risk management which can be carried out in two main areas:
  - allocation of assets where as large investors they will generally work within-the-system
  - stewardship of assets where as universal owners there are change-the-system opportunities.

- UO’s will work within these mantras:
  ‘The returns we need will only come from a system that works. The benefits we pay will be worth more in a world worth living in’

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*hyper-integrated risk management is integration across asset classes and risk drivers; time horizons; utility for stakeholders; financial and extra-financial factors
Stewardship and system-level investors
Examples of stewardship that address systemic risk

The Church of England Pensions Board
- Developed Stewardship Implementation Framework that sets out its strategies for “systemic or strategic interventions that will have wider impact than standard corporate engagement”

New Zealand Superannuation Fund
- Promoted a framework of incorporating climate change into asset pools to other sovereign wealth funds

CalPERS
- Believe that climate change is a systemic risk to their portfolio
- Launched Climate Action 100+, along with PRI, Ceres and IIGCC, to drive the transition to a low-carbon economy
How additional resources would be used

Top three stewardship activities attendees felt need the biggest resourcing increase to achieve long term value for beneficiaries/clients?

1. **Company engagement**
2. **Policy engagement on ESG issues**
3. **Research and data analysis**

Source: PRI In Person 2022 – polling results from Empowering active ownership

What would you do with additional resources

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<tr>
<th>Activity</th>
<th>Scores</th>
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<td>Better quality engagement at industry /policy level</td>
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<tr>
<td>More engagements at industry /policy level</td>
<td>77</td>
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<tr>
<td>Better quality involvement in collaborative engagement</td>
<td>74</td>
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<tr>
<td>Improved reporting</td>
<td>70</td>
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<tr>
<td>Increase/ improve use of ESG data and research</td>
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</tr>
<tr>
<td>More 1to1 engagement</td>
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</tr>
<tr>
<td>Better quality 1to1 engagement</td>
<td>67</td>
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<tr>
<td>More collaborative engagements</td>
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<td>More informed voting</td>
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<tr>
<td>Filing more resolutions</td>
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Source: TAI/PRI stewardship resourcing technical working group polling n=21

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<td>Very unlikely</td>
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</table>

Source: TAI/PRI stewardship resourcing technical working group polling n=21
Call to action for individual organisations

1. Measure current stewardship resourcing by using the Stewardship Resources Assessment Framework.

2. Build a stewardship strategy appropriate for your organisation, that is aligned to the industry vision of doubling resources. The size (the quantity) and shape (the seniority profile and mix of skills) of the resourcing strategy should be a central tenet of an organisation’s strategy.

3. Play an active part in asset owner – asset manager engagement discussions. An engagement in which the asset owner has a much clearer ‘ask’ of the asset manager, and the asset manager delivers a much more accountable response.

Call to action for the industry

1. Generate better information on stewardship resourcing. Better industry-wide data will help inform organisation-specific actions in stewardship. Policy makers can play a key role in providing clear guidance and expectations with regards to stewardship resourcing practices and their disclosure.

2. Require stronger standards of disclosure on stewardship resourcing. This represents an important step in building greater transparency in a field of growing importance.

3. Advance research into effective stewardship practices. To date, the stewardship side of investing has had limited focus; there should be much greater attention given its significance in achieving industry goals.
Appendix
Systemic risk

The risk of a breakdown of an entire system rather than failure of individual parts

- A special part of market or systematic risk
- Arising from malfunctions in the system that cascade through the whole market
- Very different from classic ‘market risk’ particularly in term structure with path dependence being critical

- Limited history to inform the future including usefulness of stress testing
- Pricing this risk is near impossible (the risk has high uncertainty/low tractability)
- Future risk distribution has limited upside and potentially severe downside
- Systemic risk seems on its way from ‘nbd’ to ‘omg’*
  * no big deal to oh my goodness

Overview

1. Increased stewardship resourcing
2. Engaged AO-AM relationship
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Way forward

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In history

- Systemic risk historically has been about financial interdependency risks and geo-political risks
- Systemic risk downside historically has been smallish but subject to bursts and spikes

In future

- Systemic risks in the future are increasingly from climate, environmental and social sources
- Future systemic risk likely to be orders of magnitude bigger than prior versions
1. **Systemic risk** - the *use of systemic risk models and systemic risk scenarios* is particularly valuable in assessing systematic risks.

2. **Systems leadership** - the *use of systems leadership models*, which recontextualise problems as shared problems and use systems thinking to explore and solve the problem.

3. **Beliefs** - the *use of system patterns* to understand the present landscape and plan for the future.

4. **Sustainability** – the *use of systems-level investing* in which the three dimensions of risk, return and impact are integrated.

5. **Measurement** - the *use of balanced scorecards* in which measuring and incentivisation is addressed more holistically and systemically.

Source: [TAI Systems Curriculum](https://www.thinkingahead.org/systems-curriculum)
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- **Purpose:** To mobilise capital for a sustainable future.
- **Vision:** To help shape a better and more sustainable investment industry that creates long-term value for end savers and contributes to a world more fit to live in.
- **Mission:** To achieve systemic change across the investment industry through innovation so that the provision of new capital and the stewardship of existing capital adds long-term value to the end saver, wider society and the planet.

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1 As of December 31, 2023

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Thinking Ahead Institute members | 37 asset owners | 14 asset managers

* Previously QSuper
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