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Our approach to Stewardship

Stewardship Code | 2020 report

We are delighted to present our first stewardship report, coinciding with the launch of the 2020 Stewardship Code. The new code, we believe, sets principles for asset owners, asset managers and, from our perspective, service providers, which if met will raise standards of stewardship.

In our report, we have set out an explanation of how we have helped clients agree their approach to stewardship, as well as how we represent their interests through our engagement with others in the investment industry. We provide a number of case studies to bring this work to life.

The challenges of 2020 have been significant, but the pandemic has provided a test of the resilience of our approach to working with clients and a "reset" of the norms that have influenced the way of working in the past. In preparing our stewardship report, it has been pleasing to be able to share all of the good work we have done with our clients, but also exciting to highlight the many opportunities for improvements going forwards.

Rod Goodyer FIA
Partner and Head of
Investment Consulting

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Principle 1: Signatories' purpose, strategy and culture enable them to promote effective stewardship.

Purpose

Barnett Waddingham is a leading independent UK professional services consultancy working with clients across investment, pensions, risk and insurance. We work in partnership with our clients to clarify and solve their complexities, in the right way. Our primary purpose is to provide clients with clear and accessible advice and services, through a personal, quality, tailored approach. We seek to build stable and long-term partnerships with clients, supported by our low staff turnover thanks to our ongoing investment in our experts and our particular culture.

Services

We offer a full range of professional services to pension schemes, charities, corporates, insurance companies and friendly societies.

These services include advising investors on setting investment objectives and policies, designing investment strategies, selection and monitoring of fund managers, oversight and evaluation of fiduciary managers, establishing effective governance frameworks and considering sustainability and climate change. All our work is advisory as we do not manage money nor promote our own funds.

We provide a broad range of actuarial services to pension schemes, insurance companies and friendly societies. We also provide full administration services to pension schemes as well as specialist pensions management and governance services. Our pensions advisory services are focussed on ensuring that returns are appropriate to ensure dignity and comfort in retirement. Our risk advisory and management decision analytics experts support clients across the business.

We are a leader in the provision of self-invested personal pensions (SIPPs), through BW SIPP LLP, small self-administered pension schemes (SSASs), specialist executive pension plans (EPPs) and other retirement arrangements.

Our culture and values

"Do the right thing" – this is the simplest way to summarise our culture. This mantra applies to both clients and our people, and so the partners work hard to instil this across the business.

Our people are key to the success of our business and we are proud of their loyalty and commitment to delivering a quality, efficient client service. People who join Barnett Waddingham tend to stay, thriving in a professional learning environment and caring, friendly culture.

Our values drive how our people act. These values help guide us and bring us together as one team. We've distilled this down to four statements which are embedded across the entire business.

Principled - We are committed to maintaining our high ethical standards whilst considering the impacts on all our stakeholders. We behave in a manner that demonstrates our honesty, conviction, pride and responsibility to keep our promises. We continue to uphold our reputation as an independent partnership that has integrity at its core.

Quality - We don't compromise on quality; excellence is the norm across our whole business and we consciously look to provide innovative solutions that deliver ongoing value to every client.

Partnership - By working collaboratively within the firm and with our clients, we are able to deliver a seamless service by encouraging both individual excellence and teamwork within our business. Our unified approach ensures we are working together toward the same goals and desired outcomes.

Respect - We recognise and respect the value of everyone's contribution to our success, honouring our diversity and the positive effect we have on our communities and the environment.

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Business model and strategy

Barnett Waddingham has a clear governance structure led by our Management Board who oversee our activities. They set the overall direction of the business, its key objectives, and the strategies to deliver.

The Management Board comprises of eight partners, three of whom are elected, and has an independent chair, Elizabeth Renshaw-Ames, to ensure constructive discussions take place to reach the right decisions and to bring an external and independent view to ensure there is appropriate challenge (see Figure 1).

Each service area is run by a Business Area Leader, with the investment consulting area led by Alex Pocock (during 2020) who is also Management Board sponsor for Sustainability for BW. Management Board's role includes setting the firms' overall sustainability objectives, as well as supporting the set-up and operation of sub-groups within the firm to deliver those objectives. In addition to Management Board, the firm also has a number of other boards overseeing areas such as People, Professional Risk & Compliance, Nominations and Finance.

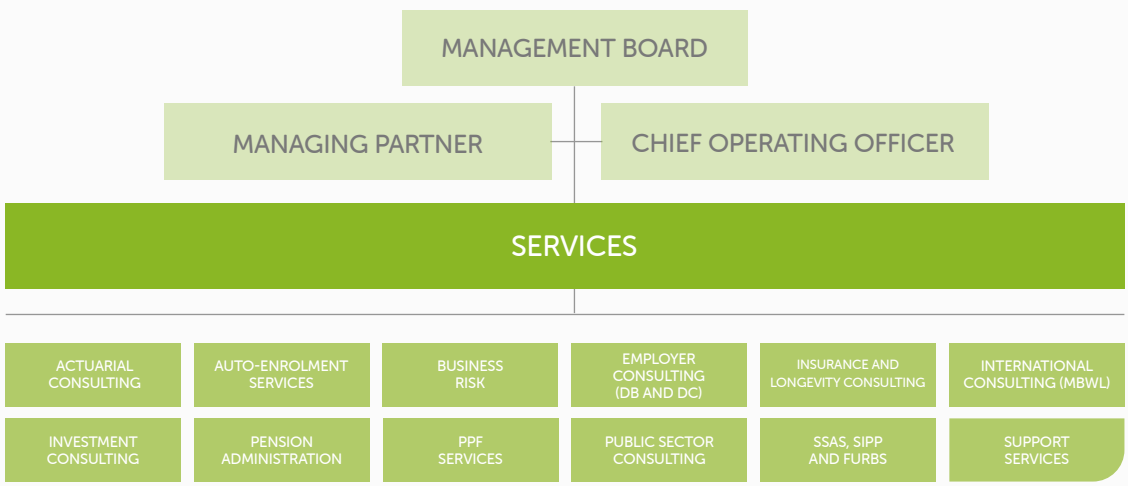
Our firmwide strategy is set by our Management Board based on the dual principles of focus and impact; we choose to actively focus on specific areas where we can have an outsized impact by our direct activities.

In 2020, we made sustainability a priority at BW across our operations and our work with our clients – much of our work in 2020 at Management Board level was focussed on the commitments we could and should make in respect of ESG and stewardship. For us, sustainability is about focussing on meeting the needs of the present, without compromising future generations and we think sustainable businesses benefit the economy, the environment and society, and this is the basis on which our approach is set.

To support our sustainability objective, we focus our work on our discussions with clients, helping them define and implement their strategies through a range of skills and tools, including data analytics, risk management frameworks, investment expertise and communications. We support this by having working groups to lead on sustainability within each of our investment, actuarial and insurance practices, for example, and these groups exchange views on a regular basis.

Barnett Waddingham forms a key link between our asset owner clients and the asset managers undertaking stewardship on their behalf. Stewardship is undertaken by fund managers selected by our clients based on the advice we provide.

Figure 1: Barnett Waddingham's structure and services



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Activity and outcome

"Stewardship is the responsible allocation, management and oversight of capital to create long-term value for clients and beneficiaries leading to sustainable benefits for the economy, the environment and society."

We have demonstrated our commitment to stewardship in this context in a number of ways, including those set out below. Underpinning all of our work in this area, however, is our long term partnership approach. As a business, wholly owned by our partners, we are focussed on maintaining long term relationships with clients. This is facilitated by our culture, which promotes sustainable relationships with clients by, for example, not setting individual income targets for consultants or for clients, so that the focus can be on doing the right thing aligned with the interests of clients and the business.

Economy:

- We work with all of our clients to set and report on the implementation of stewardship policies within their investment strategies - in our work advising clients on setting investment objectives we are increasingly including climate change, sustainability and stewardship as core objectives.
- We do this by undertaking training and discussions on responsible investment with our clients, and supporting our consultants with a programme of training during 2020. The topics we addressed during the year included ESG-tilted equities and impact investing (particularly through investments such as social housing).
- Criteria and stewardship credentials are a part of all of our manager research and fund recommendations – this includes reviewing their voting and engagement policies, their resources, and their activity data. We assess managers (and asset classes) against their peers and against our own expectations of good standards. For example, in 2020 one of our university-sponsored clients removed a manager from their portfolio as a result of the poor ESG credibility identified through our research.
- We report on the ESG and stewardship credentials of clients' managers and strategy on an annual basis. As part of this, we request data on PRI signatory status and ratings, stewardship code signatory status, voting/engagement statistics. We also discuss reports with clients and highlight any ESG/stewardship concerns and educate and encourage them on how they might engage with their managers on ESG/stewardship.

- At a firm level, we are members of the Investment Consultants Sustainable Working Group (ICSWG – see Figure 2), we participate in Pensions for Purpose and are supporters of the Impact Investing Institute. The individuals who represent Barnett Waddingham within these groups share any discussions and learning with our Sustainable Investment Team, and the wider firm, depending on the nature of the information.
- We are represented on the Pensions Climate Risk Industry Group (PCRIG), the cross-industry group tasked to produce guidance for pension schemes on how they can adopt the Taskforce for Climate-related Financial Disclosures (TCFD) recommendations on climate governance and disclosure. Supported by the DWP and TPR, the group was convened in mid-2019 and published climate guidance for pension scheme trustees in January 2021. Our colleague Amanda Latham was closely involved in the drafting of chapters on governance and risk management, and reviewed drafts of other chapters.
- The outcome of this activity is that, in aggregate, our clients (and the collective value of their assets) are now more resilient to the evolving challenges of ESG and responsible investment, and contributing to the economic challenges ahead. In addition, our clients have better training and knowledge to carry out their fiduciary duty, ensuring more robust governance going forwards. As an example, we now ensure that our quarterly market outlook takes account and comments on ESG matters, and any investment manager update presentations provided to clients now include an ESG update.

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Environment:

- We work with our clients to educate them on the particular aspects of ESG related to the environment and climate change. This included, for one of our local authority clients, working with an investment manager to design and launch a product in 2020 to meet their specific net zero target.
- We undertook an internal study during 2020 on the impact that BW has on the environment. The results of this study will inform our environmental policy going forwards. The study has allowed us to identify ways to minimise office waste and non-renewable energy consumption, improve supplier sourcing to match our vision on sustainability and provide staff with opportunities to make an impact. This has informed our plans going into 2021. In light of the Covid-19 pandemic, we have been able to consider our policy on business travel and how we utilise our office space, unencumbered by the norms of the past. Further work on this is ongoing.
- Having made a significant reduction in our carbon footprint by reducing emissions across the business, we now commit to be net carbon neutral for scope 1 and 2 emissions (and net zero including scope 3 emissions by 2025), which we believe is a material outcome of this process. BW also pledges to continue to do the right thing and reduce our carbon footprint by only using high quality, nature-based offsets to achieve neutrality. We are also promoting and underlining the importance of ESG/climate to stakeholders (clients, managers, etc.) through this ambitious commitment.
- The outcome of this activity is that we have a lower environmental impact than in previous years and clear targets in place to continue those reductions over time.

Society:

- We work hard to promote diversity and to develop an inclusive culture by a process of continuous improvement through our D&I action plan.
- During 2020, we have established internal employee forums in respect of gender equality, LGBT+, wellness, early careers, faith and ethnicity, which around two thirds of staff are members of, providing support and community to our people.
- Our action plan includes working on our recruitment and onboarding processes, and also developing our WorkSmart policy to improve the flexibility in the way that people can work. Our latest staff survey, which covers 2020, indicates that this policy, although in its infancy, is highly valued. 96% of staff believe that the service they have been able to deliver during Covid is at least as good or better than before.
- The outcome of this activity for clients is to put in progress a plan to improve diversity of thought and ideas within our team, so that the advice that we provide to clients continues to evolve and innovate to support effective stewardship.

Figure 2: Investment Consultants Sustainability Working Group (ICSWG)

Formed during 2020, the group's purpose is taking action to support and accelerate sustainable investment initiatives in the UK. BW colleagues played a core role in establishing the working group and building support across the industry for collaborative efforts to achieve change. We are represented on the Steering Committee and play an active role in three workstreams, including chairing the Stewardship workstream.

The activities and outcomes we contributed to in 2020 include:

Stewardship:

- Developing a tool to improve transparency and consistency of reporting on engagement activities by asset and fiduciary managers
- Supporting use of the Pensions and Lifetime Savings Assocation (PLSA) vote reporting template as a minimum for firms who are part of ICSWG
- Regular engagement with the Financial Reporting Council (FRC), Financial Conduct Authority (FCA), The Pensions Regulator (TPR) and Department of Work & Pensions (DWP) on stewardship expectations and how investment consultants can facilitate improved stewardship
- Engaging with the Association of Member-Nominated Trustees (AMNT), Investment Association (IA) and Asset Management Taskforce recommendations for investment consultants on split voting and stewardship

Asset owner:

- Producing standardised definitions for responsible investment
- Developing a guide for minimum expectations of investment consultants, aimed at smaller clients

Regulation:

- Responding to DWP's climate change governance and disclosure consultation and the International Financial Reporting Standards (IFRS) Foundation's sustainability reporting consultation
- Publishing a guide to investment consultants' climate competencies included in the Pensions Climate Risk Industry Group (PCRIG) guide to climate governance and disclosure for pension schemes.

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Principle 2: Signatories' governance, workforce, resources and incentives enable them to promote effective stewardship.

Governance

Sustainability and our commitment to it is driven from the top, with Management Board setting it as one of our strategic priorities, and providing a firmwide sponsor for our sustainability activities and services. Our investment consulting practice leads our work in promoting effective stewardship to clients, and in particular, our Sustainable Investment (SI) team.

We previously had an ESG team in place for several years. In 2020 we evolved this into our SI team, made up of consultants and research analysts in our Investment Consulting business area, to increase and develop our focus on sustainability, including stewardship, and drive even better outcomes for our clients.

The SI team ensures our investment consulting practice has the knowledge and ability to advise clients on all investment matters related to sustainability, like climate change, stewardship and integrating ESG, whilst supporting the sustainability objective of Barnett Waddingham. We will continue to refine and develop our approach as we bed in our new sustainability governance structures in 2021.

The SI team forms a robust governance structure, made up of four teams (with some colleagues being part of more than one team, giving greater breadth of knowledge while ensuring accountability for delivering the team's objectives).

The existence of each group is to provide focus as regards direction of work. The SI team works collegiately and aims to integrate with the whole of the Investment Consulting area and the rest of the Firm.

The SI team steering group has the responsibility to drive the work of the SI team. It is the first port of call for all matters related to sustainability and the chair of the SI steering group reports to the Head of Investment Consulting. The group's work is also overseen by our Managing Consultant, who is the BW Management Board member with overall responsibility for sustainability. The steering group also works closely with Matt Tickle, Partner and Head of Research, to ensure sustainability is embedded in all our research in a consistent manner – indeed, sustainable investment, stewardship and ESG is prevalent across our research teams. For example, as explained later, all of our manager research activity includes assessment of managers' ESG credentials.

The SI team steering group comprises:

- David Clare
  Partner and Chair of Sustainable Investment
- Pete Smith
  Principal and Senior Investment Consultant
- Eva Grace
  Investment Consultant and senior member of Sustainable Investment
- Su-Ching Lee
  Senior Sustainable Investment Analyst
- Amanda Latham
  Associate and Policy & Strategy Lead

Projects are undertaken by a group of around 20 members of the wider SI team, focused on research, propositions and operations:

SI STEERING GROUP

SI RESEARCH GROUP

SI PROPOSITION GROUP

SI OPERATIONS AND LEGISLATION GROUP

- The SI research group is responsible for matters related to knowledge gathering and understanding.
- The SI proposition group is responsible for understanding the needs of our different client and prospective client groups within sustainable investment. This involves taking outputs from research group and operations/legislation group and turning them into solutions, enabling clients to act on sustainability.
- The SI operations and legislation group is responsible for the organisation of the SI team as well as bringing understanding and input from legislation and industry working groups. This includes preparing clients for what's ahead and informing them what actions they need to take to manage sustainability.
- We put these structures in place later in 2020 and our initial evaluation shows this is a more effective way to deliver stewardship for our clients than our previous set up, with greater levels of resource and expertise now in the SI team. As we move into 2021, we will continue to develop our sustainability structures to ensure we provide the best possible service to our clients and continue to support their effective stewardship.

Quality and accuracy

In order to ensure the quality and accuracy of our services in respect of stewardship, we undertake a range of work within the team so that our consultants are best placed to effectively advise clients:

- We provide comprehensive training, including stewardship, to all members of the team, from introducing the high-level principles to new graduates, to detailed advice-focussed training for experienced consultants.
- The education for new graduates includes "rotating" into our different research teams as part of their induction programme. We also encourage all members of the team to regularly attend training provided by investment managers and industry bodies, so that we understand views and approaches, and can take new ideas to clients. Consultants can also invite SI team members to support the training and discussions they provide to clients.
- The data that we receive from managers on ESG and stewardship is checked by both the SI team and individual client teams for both accuracy and reasonableness, so that we can identify any inconsistencies or areas that managers may have reported contrary to our expectations. As part of this process, we engage with managers on the data provided and emphasise the importance of stewardship to clients and the quality of stewardship data. We aim for best practice in the process of voting/engagement data collection by using PSLA and ICSWG templates.

- All of our advice to clients is subject to an internal peer review from a senior consultant outside of the immediate client team. This review will include raising areas of the advice that are "missing" including raising important issues such as responsible investment and stewardship.
- As part of helping clients to comply with the CMA Order, we encourage a beyond-compliance approach to the annual review of our performance against objectives, taking the opportunity to reassess what clients want from us as their advisor. This includes any objectives in respect of stewardship.
- By checking and reviewing the data, information and advice we provide to our clients we ensure we have a consistent and continuously improving approach to supporting clients' stewardship.

Resourcing

Organisational and workforce structure

Our research team, including the SI team comprises 17 full time equivalent members, made up of 8 dedicated researchers alongside our consultants. Our manager research team is part of the wider research team and are responsible for day to day integration and engagement with managers. Every researcher does sustainability and ESG research to inform our overall ratings.

The investment analysts and full-time manager research staff are the key individuals responsible for performance reporting for our clients. Our focussed team of generalists with in-depth knowledge across multiple areas encourages knowledge sharing and better challenge. This allows our opinion to be well thought-out and robust, with no pressure to "sell" a specialist area.

Our research team engage with investment managers to obtain performance data, and analyse and interrogate this on behalf of our clients. This is overseen by the Investment Consulting Research Board, chaired by Matt Tickle, Head of Investment Research. Sustainability is built into the team's objectives and annual assessment and review process.

Seniority, experience, qualification(s) training and diversity

We encourage all of our investment consulting team to undertake professional qualifications, with the majority of the team studying for or qualified as an Actuary or CFA Charterholder. Of the 97 members of the team, 33 are FCA-Regulated advisors.

Members of the team who are studying to qualify with the Institute and Faculty of Actuaries (IFoA) or with the CFA benefit from a comprehensive study policy, which provides both time and money to support learning.

In addition, all of our SI team were offered additional support to study the CFA ESG qualification alongside their broader qualifications during 2020. During 2020, 3 members of our team were provided support for the qualification.

Our recruitment process evolves depending on the needs of the business over time, but key principles of our approach are:

- New recruits should ideally contribute not just academic expertise to the team, but also enhance the collective efficacy by providing diversity of thought and ideas. We continue to evolve our recruitment process to make it as effective as possible.
- A sustainable business is one which is built on a stable foundation of new graduates. During the Covid-19 pandemic, we continued to invest in our graduate programme, taking a full intake of recruits in 2020, as we believe this best supports the business and the provision of good service to clients now and into the future.

Investment in systems, processes, research and analysis

Another of the key operational sub-teams is our systems development team. They are responsible for developing our risk modelling tools as well as our internal systems for performance monitoring of client investments. By developing these systems in-house, we have full control and flexibility to adapt and tailor them to our client needs.

We have developed template ESG reporting structures, including on stewardship, which bring together the key metrics available from investment managers and presents them in an easily accessible dashboard for clients (See Figure 10). This allows clients to make effective decisions on their managers with respect to management of sustainability and practice of active stewardship. Our process for preparing these reports, and also for preparing regulatory disclosures like implementation statements, is standardised at the data collection and analysis stage. This stage is undertaken by the research team to make this as cost efficient as possible for clients, and then allows the individual client teams to add value specific to client needs when the report is finalised, so that all clients get tailored advice. Our approach to monitoring ESG and stewardship continues to evolve as the information available improves, and the needs of clients evolves.

Our research capability in sustainable investment has grown during the last year, with the recruitment of a specialist in SI joining the team, and we continue to target recruitment in this area. We also have plans in 2021 to enhance the ESG data that we receive in order to further improve our research and reporting to clients.

Incentivisation

Our annual personal development review process promotes good practice throughout our team, with a focus on providing top quality advice to clients. As a minimum, this means helping clients to comply with the latest legislation on stewardship, but for consultants to demonstrate best practice they must be delivering beyond this, helping them to understand how good stewardship can enhance investment outcomes. All else being equal, remuneration will therefore be aligned with consultants delivering effectively on stewardship to clients.

Fees

During 2020 we set up a template fee modeller to assist our consultants in setting fees for clients, to help ensure consistency and fairness to clients. We regularly test the fees we charge against the market (e.g. by taking feedback following new business tender processes, through discussions with independent trustees and via external surveys such as that carried out by Greenwich Associates), so we are confident that our fees represent excellent value for the quality of service we provide.

In order to provide our clients with good value for money, we carried out the majority of the work needed to collate and analyse data for the first round of implementation statement reporting centrally, and then shared the cost across clients, rather than charge "time-cost" for each individual client. We believe this is good demonstration of fairness to clients, so that those who were first to complete the work were not subject to higher costs.

We also provide regular free educational material to clients, through our annual investment conference (which included a session on "practically addressing ESG" – delivered in early 2021 based on research carried out in 2020) and client briefings or blogs (e.g. "How easy is it to switch to an ESG aligned passive fund?").

All of our advice to clients in respect of fund selection will include a section which compares the cost of investing on a like-for-like basis – we seek to include both explicit fund management charges, and implicit costs (e.g. turnover).

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Principle 3: Signatories identify and manage conflicts of interest and put the best interests of clients first.

Barnett Waddingham is committed to identifying, monitoring and managing all actual and potential conflicts of interest that can arise between both our clients and us, as well as between clients in all areas of our business.

For all conflicts of interest, Barnett Waddingham takes reasonable steps to prevent these conflicts giving rise to material risk of damage to the interests of any of its clients. There are a number of areas where conflicts may arise which are as follows:

- Barnett Waddingham provides advice to a wide range of organisations and their pension schemes. This includes entities in the same group as firms whose products Barnett Waddingham may recommend. We will notify explicitly any potential conflicts that we perceive have arisen;
- Barnett Waddingham provides advice to other clients in the same business sector;
- Barnett Waddingham provides a range of services to pension schemes. Barnett Waddingham's advice may include the undertaking of further work for which Barnett Waddingham is a potential provider.

Figure 3: Conflicts of Interest Policy

Where we identify conflicts of interest we acknowledge the importance of taking appropriate steps to mitigate and disclose the risks as per our internal policies and procedures reference. In summary and wherever possible effort will be made to:

- Avoid conflicts between personal interests, or the interests of any associated company, person or group of persons, and duties to clients;
- Avoid conflict between any competing interests of one or more client, stepping aside if such conflicts cannot be resolved;
- Avoid conflict between personal interests, or the interests of any associated company or person, and duties to Barnett Waddingham.

Where conflicts cannot be avoided, efforts should be made to mitigate the risks as specified in the policies and procedures previously referenced, and/or where appropriate, by the following means:

- Effective procedures to prevent or control the exchange of information between the relevant persons where the exchange of such information may harm the interests of one or more clients;
- Separate supervision of relevant persons whose principal functions involve carrying out such activities on behalf of, or providing services to, clients whose interests may conflict, or who otherwise represent different interests that may conflict, including those of the company/firm;
- Measures to prevent or limit any person from exercising inappropriate influence over the way in which a relevant person carries out investment or ancillary services and/or activities;
- Measures to prevent or control the simultaneous or sequential involvement of a relevant person in separate investment or ancillary services or activities where such involvement may impair the proper management of conflicts of interest;
- Segregation of duties that could give rise to conflicts if carried out by the same individual.

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Activity and outcome

We train all our staff on our conflicts policy on induction and provide regular updates to training (e.g. annual training on anti-money laundering and compliance regime changes).

All clients are the responsibility of a partner at Barnett Waddingham. Prior to and on appointment, we check for conflicts with each of the partners and other senior members of firm's client-facing personnel. Any potential conflicts are raised with our Governance team for management.

Where a potential conflict is identified, we will investigate whether this is actual or perceived and whether it is manageable. If appropriate, we have the technology in place to set up separate client teams, with access to documentation restricted to ensure no breach of a conflict. If this were the case, any proposed approach would be agreed with the clients beforehand, and in the event that an approach could not be agreed, we would decline to remain appointed to one or both clients.

We do not accept commission on investments unless our clients specifically instruct us to do so and it is in their interest, in which case we will offset it against our fees. Commissions are sometimes arranged on risk benefits, for example life assurance and stakeholder or personal pension arrangements but only with the client's agreement. All commissions are declared.

We do not manage any assets or provide fiduciary management services (where trustees delegate the majority of investment decisions). As independent consultants we offer our clients unbiased investment advice across the whole of the market. We are also ideally placed to provide an expert independent fiduciary management oversight service to trustees who are considering or who have chosen to go down a fiduciary management route.

Figure 4: Case study – Managing conflicts of interest

During 2020, one of our charity clients we work with experienced weakening of the historically strong employer covenant, so that a conflict in advising both the charity and the pension scheme trustees became unmanageable for one person. We therefore segregated the roles and applied barriers internally between the teams, working with the client to devise a conflict management plan. The high level principles of the plan were:

- To set up separate email folders and addresses for the charity advisory work and pension scheme advisor work, with access restricted only to members of the BW advisory teams of the respective entities.
- To set up separate system folders for files for the charity advisory work and pension scheme advisor work, with access restricted only to members of the BW advisory teams of the respective entities.
- Systems were password protected by user, to prevent circumvention of the email and folder controls system.
- Information in relation to the two entities would only be shared between the two advisory teams where permission is explicitly granted by the charity or pension scheme trustees.
- No client-related discussion between the two teams, except where given permission by the charity and pension scheme trustees.
- Appointment terms were updated, with separate partners responsible for each appointment.

The conflict management plan resulted in an effective ongoing relationship with both entities. This included undertaking a robust negotiation around the Actuarial Valuation during 2020, under which the trustees of the pension scheme were able to secure a funding plan to target greater security for members, along with greater certainty of costs for the charity.

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Principle 4: Signatories identify and respond to market-wide and systemic risks to promote a well-functioning financial system

Market-wide risks are those that lead to financial loss or affect overall performance of the entire market and include but are not limited to:

- Changes in interest rates
- Geopolitical issues
- Currency rates

Systemic risks are those that may cause the collapse of an industry, financial market or economy, such as climate change.

Activity and outcome

Identifying and responding to market-wide and systemic risk

We identify market-wide and systemic risks through both formal and informal approaches:

- Our manager research team conducted over 300 meetings with managers during 2020. These meetings cover both specific aspects of the management of their funds, but also cover market-wide issues, so we can identify themes that continue to be raised, or "quirky" ideas which may grow into more significant issues.
    - As a base, we ask all managers a consistent set of questions on their approach to stewardship, and then undertake specific questioning as part of our research meetings.
    - In advance of the Brexit transition period ending, we surveyed over 100 managers to assess their readiness for the changes, so that we could alert clients to any risks in respect of asset values or administration of their assets.
- Alongside our manager research team we also have a strategy research team which is responsible for carrying out our economic outlook research and research on individual asset classes. A recent example of their output promoting sustainable investment has been the identification of responsible social housing as an investment opportunity, due to the responsible investment benefits and the supply shortage in the social housing sector. This developed from work we were doing with one of our local authority clients, who wanted to support their local areas through their investment portfolio, while also generating strong returns. The overall research agenda of each of the research teams is set by Research Board, to ensure that we have a robust strategy to the way that we deploy our resource.
- Our research is disseminated to the team through regular (monthly or quarterly) updates, and to clients in research papers and webinars throughout the year.
- By engaging in industry bodies and participating in consultations issued by regulatory bodies, we also maintain awareness of emerging risks and help shape the way that our clients respond (see Figure 5).
- We promote a "free-thinking" culture within the team so that consultants and trainees are able to spend time reading and attending seminars/webinars so that they can generate ideas or challenge our central research output.

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Figure 5: Case study – Working to manage systemic risk

One of the biggest risks that our DB pension scheme clients face is exposure to interest rates and inflation in the calculation of their liabilities, which isn't matched by their assets. By utilising our risk modelling software, we have been able to illustrate the impact of this risk to clients, which if crystallised simultaneously across many pension schemes would result in a material risk across the UK economy.

The ability of schemes to manage this risk has to be balanced against affordability, but through the use of Liability Driven Investments (our expertise in which is robustly supported by our specialist LDI team), clients have been able to more efficiently use their assets to manage the risk. The timing for those schemes wanting to increase hedging has not been ideal in recent years due to persistent low yields.

However, by providing training to clients, it meant those schemes wanting to increase hedging were well-placed to take advantage of gilt yield volatility during the pandemic, and inflation volatility as a result of the Government's RPI reforms which played out during late 2020. In the most significant case, we worked with a client to identify that it was affordable to move to a position of being 100% hedged, from being 10% hedged, in the space of around one month, materially reducing their investment risk.

> The ability of schemes to manage this risk has to be
>
> *balanced against affordability*

Our role in industry initiatives

Our colleague, Esther Hawley, is part of a working group with the Institute and Faculty of Actuaries (IFoA) redrafting the guide "Climate Risk: A call to action for Actuaries working in Defined Contribution Pensions" that includes stewardship. The updated practical guide will support the actuarial profession with climate risk and raise awareness of the topic, encourage discussion, catalyse further research and help actuaries to think about how to develop their advice for defined contribution (DC) pension schemes. Collaborating with others in the actuarial profession we look to drive improvement in how this is integrated into DC investment.

We are members of Pensions for Purpose, a collaborative initiative of impact managers, pension funds, social enterprises and others providing thought leadership on impact investment and won the 2020 Award for Best ESG Thought Leadership.

We are also pro-bono supporters of the Impact Investing Institute, an organisation set up in 2019 to accelerate the growth and improve the effectiveness of the impact investing market in the UK and internationally. We routinely include impact as a topic for consideration, and support clients to review, set targets for and monitor the impact of their investments.

As a firm, we are active members of the Society of Pension Professionals (SPP), with several of our people involved in committees. Our Partner, Neil Davies, is current chair of the investment committee, and he has actively sought to include ESG and stewardship on the agenda of the meetings he has chaired in order to facilitate collaboration between professionals from throughout the investment industry. The Chair of our SI team, David Clare, is a council member of AIMSE, working to support the inclusion of ESG topics on the agenda of their conference, round table and academy sessions.

We consider that our approach, in using our knowledge, skills and resources to effectively collaborate with others to advance stewardship, results in further development of stewardship in the investment process and helps our clients deliver long-term value in terms of their investments.

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Figure 7: Case study – Effective identification and response to systemic risk to help promote well-functioning markets

When the Covid-19 pandemic hit in March 2020, we were quick to respond to help clients navigate through the challenges. Our response included the following:

- Ensuring the robust functioning of our own systems to ensure that we could continue to deliver a seamless service from home
- Swift communication (within days) to clients with a "checklist" of urgent matters to address e.g. ensuring pensions could continue to be paid
- Using our funding monitoring system, or ad-hoc updates for clients, to estimate the positive or negative impact on funding levels so that we could propose action to clients
- Quarterly updates on the performance and outlook of different asset classes, including detail of the extent to which companies with good stewardship and ESG credentials fared better than others, in many cases. This was an existing resource that we provided clients, but it proved especially beneficial during the crisis.
- Communication to clients on how to ensure effective governance in a world of remote meetings, sharing learning derived from our in-house experiences.

Figure 8: Case study – Effective identification and response to systemic risk to help promote well-functioning markets

In response to the Government's consultation on, and subsequent changes to the Retail Prices Index, we were one of the leading commentators and thought-leaders in this area. Lead by our LDI and RPI research experts, we provided detailed and free research to all clients (initially in 2019 and updated in 2020) to explain the potential issues, and then provided detailed client-specific advice to those clients most-affected.

For example, to help manage the risk of an unplanned mismatch between their assets and liabilities we worked with clients to make changes to their investment strategy. This helped to avoid exacerbating a systemic risk pervading DB pension schemes.

We also supported multiple clients in preparing their own responses to the consultation, where the impact was particularly detrimental to the security of members' benefits.

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Principle 5: Signatories support clients' integration of stewardship and investment, taking into account, material environmental, social and governance issues, and communicating what activities they have undertaken.

Our investment consultancy client base is summarised as follows:

- 420 UK defined benefit pension schemes
- 82 UK defined contribution pension schemes
- £77bn assets under advice
- Clients range in size from £1m to multi-billions of pounds
- In additional to pension funds, we also advise charities on their investment strategies and companies on their invested assets. This provides us with perspective across a range of asset owners, beyond only pension schemes.

Activity and outcome

How our services best support clients' stewardship

Our ABCs process – looking at clients' Aims, Beliefs and Constraints framework in setting investment objectives – is where we help investors identify their specific ESG considerations and develop their own ESG and Stewardship policies. We undertake this process when considering how best to support new and existing clients to identify their investment beliefs and support manager selection.

We think ESG and stewardship should pervade everything investors do within their strategy. For the majority of our pension clients, 2020 has involved putting in place SIP policies on stewardship and developing our approach to helping clients with implementation statement reporting, looking at the voting and engagement taking place on behalf of our clients.

Figure 9: Case study – recognised best practice

The Defined Contribution Investment Forum (DCIF) undertook research in 2020 and published the Good Citizen's Guide to ESG, setting out an example of a good SIP based on the work we undertook with our clients. The report highlighted their stewardship policy clearly outlining the governance, oversight and that it forms part of the selection criteria for managers. The policy included:

- The trustee will monitor and engage with the investment managers in relation to stewardship activities as follows:
- The trustee will, with support from the investment consultant, review the stewardship policies, voting and engagement activities of the scheme's investment managers periodically. In the case of any specific issues or questions being identified through this monitoring process, the trustee will engage with the scheme's investment managers for more information and discuss any remedial actions taken.
- The trustee will also ask managers to attend meetings from time to time to present and discuss their stewardship activities, which may include details of any voting rights exercised.
- When selecting investment managers, where appropriate and applicable, the trustee will consider the investment managers' policies on stewardship and engagement, and how those policies have been implemented.

The inclusion as an example in the DCIF's report shows recognition of our effective approach in developing SIP policies with our clients including policies on stewardship for those using pooled funds for their equity investments.

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How we support our clients' stewardship

In 2020, we continued to improve our manager research process, developing our approach where we look into how a manager integrates ESG risk-assessment into their investment processes and the extent to which a manager is an active owner. Stewardship is a key part of our ESG rating system, where we set out for our clients the credentials of asset managers who can run their investments. The system assesses managers on their:

ESG research: the amount and quality of research into ESG issues.

Stewardship: the extent to which the managers use their voting rights and engagement opportunities to influence companies' business activities.

ESG integration: how well the investment process of the fund is refined in order to capture the relevant ESG risks and to put a "value" on them.

Climate considerations: how exposed the fund is to climate risk or how much it is contributing to climate change through its investments.

We assess and rate these four elements of the ESG approach (high conviction, acceptable and low conviction) and present our clients with one final ESG rating, along with sub-ratings for each of the four elements so that clients have full transparency on the manager's performance. This rating is the outcome of the evidence provided by the managers and a qualitative discussion by all members of the Manager Research team where the ESG approach is discussed in the context of the fund.

The weighting, or importance, of each of the areas we assess a fund on in terms of ESG is determined by the SI team specialists in our Manager Research team and varies by asset type.

Where a manager rates low conviction in ESG, we would not expect to shortlist them in advice to clients.

In order to raise industry standards, we provide feedback to managers on any areas of our assessment which have scored poorly, and also engage with managers in respect of specific client concerns or requirements, such as the case study set out later where we developed a new fund with an asset manager to meet a client's needs. We have also, when preparing client implementation statements and ESG monitoring reports, engaged with managers on their stewardship activities and reporting, to encourage greater transparency and data quality. Through these discussions, we assist them in incorporating sustainability best practices into their "standard" funds, rather than launch new funds.

We also support the Association of Member-Nominated Trustees (AMNT) Red Line Voting initiative that aims to enable pension schemes to take a more active asset ownership role by providing investors in pooled funds with a template voting policy on ESG issues that they can ask their managers to adopt. For example, we confirm whether managers apply Red Line Voting guidelines and present the responses from managers within our ESG reporting.

We invited Janice Turner, AMNT co-chair, to speak at our January 2020 Investment Conference attended by over 300 clients and industry professionals, on Red Line Voting to increase awareness for our clients of stewardship and what investors in pooled funds can think about. As the market develops, our manager research process will identify where investors can implement their own voting policies in pooled funds.

Seeking client views and feedback

We take the views and feedback from our clients seriously.

At a specific client level, we seek feedback as part of our regular meetings and engagements with clients. This is typically undertaken by the partner responsible for our services. We have also embraced the requirement for clients to set and review CMA objectives to undertake a thorough review of our services at least annually. We encourage clients to include an evaluation of ESG and stewardship as part of this assessment, by including them in the templates that we provide clients to assist in the assessment process.

We also have a programme of independent partner reviews for key clients whereby a partner otherwise unconnected with the day-to-day delivery of services meets with the client to hear views on our service. Such exercises provide useful feedback on the quality of service provided by our teams. These are normally conducted every two years. In 2020, there were independent partner reviews carried for 28 clients which covered investment consulting services.

At a wider level, we commission Investor In Customers to undertake a client satisfaction survey on our behalf every 2 years. This covers the proactivity, clarity and professionalism of our advice. The feedback from these surveys is reviewed by the partners, and used to develop our proposition, and to identify any areas for improvement at an aggregate or individual client level.

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Investor in Customers

Investor in Customers (IIC) independently assesses companies based on feedback from clients, staff, managers, and IIC's own perceptions.

In 2019, we achieved the 'Gold Award' for our pension consultancy and pension administration services, achieving consistently high scores across the four guiding principles: understand client needs; meet client needs; delight clients and; engender loyalty. This assessment will be repeated during 2021.

Investor in Customers® Gold 2020

Communicating with clients

We meet face-to-face (whether in person, or more recently, by video call) with most of our clients on a quarterly basis, and this forms the bedrock of our communication. In addition, written report, blogs, webinars and conferences allow us to keep in contact in between planned meetings.

For example, we monitor investment managers and provide investors with an easy to interpret dashboard of what their investment managers are doing well and not so well in terms of ESG and stewardship. Our monitoring includes, as standard, how the manager has voted and engaged, any companies or sectors it includes and excludes, and our opinion on manager performance, in isolation and compared to their peers. We are also now expanding our monitoring to include reporting on climate metrics.

We also provide clients with regular research notes and blogs on a range of investment topics. These include ESG, climate change, stewardship and responsible investment. Where research is of particular interest to specific clients, we will supplement the briefing note with specific commentary on how the topic is relevant to that client's circumstances.

Figure 10: Example fund manager monitoring report on voting

Taking account of clients' views and feedback in provision of services

The feedback from clients is only worth taking if it is acted upon where concerns are expressed. Some examples of how we have adapted our service as a result our 2019 client satisfaction survey and other ad-hoc feedback are set out below:

- Relative to other aspects of our service, some clients felt that we were less proactive than we could be in raising issues with them. Our approach historically has been to raise issues with clients only after consideration of whether the matter is relevant to them. Some clients, however, expressed an interest in hearing more about new ideas, even if they were not specifically relevant to them. As a result, we have worked with consultants to provide training on the best way to raise aspects of research most relevant to clients and we are also developing a system to more quickly share new ideas with clients.
- The issue of climate change is one that, through discussions with clients and as a result of our own awareness of the rapid changes in regulatory and public scrutiny, is one that some clients (and consultants) have found challenging to navigate. Our SI team have therefore worked to provide training materials to assist our consultants to deliver clear training to clients, and our manager research team have supplemented this by identifying funds which clients can invest in to improve their climate credentials, if desired.

  We are also working on how to deliver climate change scenario modelling to clients to support their climate governance and disclosures under TCFD.
- To reflect that our client base is varied in terms of the level of resource available in respect of making changes to pension scheme investment strategy, we have also proactively considered simple ways in which even clients with less resource can have an ESG impact. For example, during 2020 we have looked at simpler steps such as switching equity mandates from tracking a traditional market cap index to an ESG tilted index. During 2020 we developed flash reports for a number of clients who had provided feedback that they wanted investment monitoring information quicker than usual. We also offer a range of ESG monitoring options to client, so that clients can tailor the monitoring they undertake to fit their governance budget (by the end of 2020 we estimate that around 40% of clients had commissioned an ESG monitoring approach, with more considering their approach as we headed into 2020).

Effectiveness of communicating with clients and understanding needs and evaluating effectiveness

The continued strong growth of our business (e.g. winning new clients, doing more/interesting work with clients etc.), and specifically our investment consulting practice, is evidence of the effectiveness of our approach. Ultimately, this success is driven by us continuing to deliver to clients.

The feedback that we receive from individual clients and wider client surveys is key to the partners when considering how we develop the business, and to identifying client needs and training needs to help our consultants to deliver those needs. There are a number of forums available within the team to promote this, but the primary body responsible for delivery of our services to clients is our Investment Consulting Proposition Forum. The forum meets on a monthly basis, bringing together the leaders in each of our proposition areas, as well as our head of client service, head of external profile and head of successful clients.

This forum drives forwards changes to our offering for clients – this has included the development of a streamlined investment consulting services which helps to bring our best thinking to clients with lower governance budgets in an efficient fashion, reflecting feedback we'd received from new business tenders. Within this service, the core portfolio design reflects our views on ESG, and all of the funds that we put forward are either rated high conviction or acceptable in respect of ESG, helping to bring good stewardship to clients which might otherwise have struggled to take such strong action.

We also drive change at individual client level by listening to their specific needs. The example below highlights a case where, through our communication with a client, we have identified a gap in their investment strategy, which allowed us to understand their needs, work with an investment manager, and find a solution which addressed the need.

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Figure 11: Case study – Divestment from fossil fuels

Our client is a £400m DC scheme and is primarily focused on fossil fuel divestment from a sustainability perspective. Ultimately, they support the transition to clean energy, and at the same time they want to move their assets out of oil, coal and gas companies.

They have members who have stopped contributing to their pensions because they do not want to be invested in companies who they believe are some of the largest contributors to climate change. This obviously concerned the trustees who wanted to make sure there was an option available for these members. So we worked with the investment manager, Northern Trust, to create a passively-managed equity option, which this scheme has seeded, based on the reductions seen here.

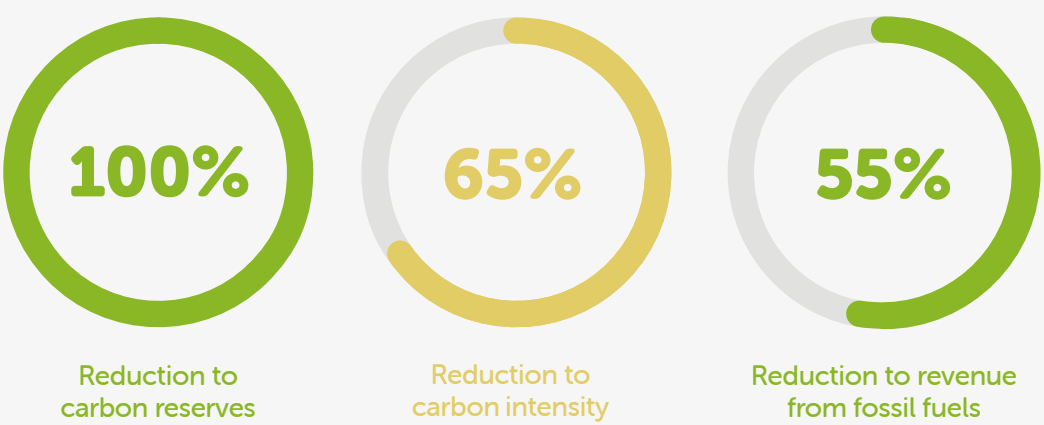
Stewardship approach

Client is focussed on fossil fuel divestment:

- Purposeful active voting and engagement;
- Looking to influence company behaviour on governance, social, ethical and environmental practices;
- Even though the fund is not invested in fossil fuels, the managers still engage with these companies
  and look for them to change their practices in the hope they will one day re-join the fund

Solution

We worked with an investment manager to create a passively-managed equity option, which this scheme will seed based on the following reductions:



Before establishing Northern Trust (NT) as the preferred manager, however, we engaged with a range of other potential managers to asset who was the most capable for the mandate.

Once NT had been established as the preferred manager, we then worked with them to agree an approach. In terms of asset allocation, we agreed that the manager would reduce the carbon footprint of the portfolio by removing all companies with carbon reserves and the top 10% of carbon emitters, while identifying and tilting allocation towards companies benefiting from the low-carbon energy transition. This means tilting towards companies with green revenues and increasing exposure to companies with solid climate strategies.

The agreed stewardship approach is particularly interesting. The approach agreed is a hybrid, where we established that they would undertake some engagement directly and also partner with a leading stewardship provider to give additional resources and scope in different countries, sectors and regions, broadening the influence and impact of the stewardship approach.

We assessed the way the manager develops a long-term dialogue with companies. Initially, they look at the material risks to the portfolio, and then they undertake structured engagement on the issues they have identified. They set objectives and make public what they expect of companies, then engage, monitor progress against milestones, and take action including voting where there is a lack of progress. We deemed this appropriate.

The manager is also very active in collaborative engagements including through Climate Action 100+ where they lead on engagement with 3 companies globally. Even though the fund is not invested in fossil fuels, the managers still engage with these companies and look for them to change their practices in the hope they will one day re-join the fund.

Principle 6: Signatories review their policies and assure their processes.

Activity and outcome

Reviewing policies and activities to ensure they support clients' effective stewardship

During 2020 our ESG team, overseen by our research board, and Partner Matt Tickle, and then our Sustainable Investment team chaired by David Clare, met at least monthly during the reporting period to review our policies and activities to ensure they support clients' stewardship.

Areas in which we have undertaken specific reviews in 2020 include:

- The overall structure of our sustainable investment research, which was completed during 2020, ready for full implementation in 2021. The changes make for more effective integration of ESG and stewardship factors within advice to clients.
- Preparing a template ESG monitoring report to provide clients with a clear and comprehensive way to assess investment manager credentials in respect of ESG, and updating our database system to more efficiently allow analysis to be carried out by the team.
- Ongoing review of ESG rating framework (including how manager stewardship is most effectively assessed)
- Updating our central database of training materials to help when educating clients on ESG and stewardship
- Regular training provided to the team to ensure that they are well-equipped to advise clients and gathering feedback from them and encouraging them to share client feedback on advice
- Adopting a flexible approach to the structure of our implementation reports prepared for clients, to reflect the scarcity of data available from some managers, while ensure compliance with the reporting requirements. We aim for best practice for our voting/engagement data collection using the PSLA voting template and the developing ICSWG guide on reporting engagement activity.
- Developing systems & processes with help of IT and the wider investment consulting team to support data collection, checking, and reporting of stewardship information for clients, including pension trustees' implementation statement reports.
- Ongoing review of ESG rating framework (including how manager stewardship is most effectively assessed) jointly by our Manager Research team and Sustainable Investment team
- Reviewing SI team membership regularly, and continue to grow the team, to ensure freshness of thought to achieve effective stewardship for clients.

Assurances in relation to activities that support clients' stewardship

Although the SI team lead the review and development of any changes we make to support client stewardship, we take feedback from across all of our partners and consultants when rolling out new developments to clients, so that improvements can continue to be made. In particular, our Proposition Forum, which is an internal group responsible for delivering quality services to clients, considers the efficacy of all of the work that we do for clients, including in respect of stewardship.

Ensuring stewardship reporting is fair, balanced and understandable

When reporting on our own stewardship policies externally, the way in which we set and develop our policies ensure this reporting is fair, balance and understandable:

- Our polices on ESG and stewardship are ultimately the responsibility of Management Board, which means that our reporting receives a high level overview and support, with communication focussed on those with or without significant knowledge of the topic.
- By having specialist SI team to drive the development of ideas, which includes research on the wider market's approach to stewardship, we are able to assess own approach against our peers. Participating in industry groups, such as the ICSWG, for example, helps to establish standards for reporting, which we have helped develop and support. As described above, we have been regularly reviewing and evolving our processes and policies during the period, and this work continues into the future, reflecting the rapid developments in the industry at this time.

To ensure that stewardship reporting to clients is fair, balancing and understandable, we recognise that the quality and completeness of data from investment managers on stewardship is variable and evolving. As a result, we standardise the information we receive by asking managers consistent questions, and provide clear definitions of the information we expect to receive.

This allows us to compare like-for-like information, or be clear where information is missing. When we report to clients, we include definitions and explanations of the information and then highlight issues which may need addressing when we meet with clients to discuss the reports. We internally review and check the information we receive before sharing with clients.

While we consider we have been successful in 2020, we are working to improve this process by learning lessons from the initial data collection exercise, so the process is more efficient and effective going forwards and hold managers to account. We are also adding a "conclusions and actions" section to our reporting during 2021 so that we can clearly highlight to clients where their managers are falling short of best practice.

Continuous improvement of stewardship practices

Our SI team stewardship project will continue to refine and develop our approach across our investment consultancy services, taking into account market developments and client feedback, along with developing policy and regulatory changes like the Department of Work & Pensions increasing focus on social aspects of investment.

We are committing to the Impact Investing Institute Principles for Pensions for investment consultants and fiduciary managers in 2021 and will evidence on an annual basis how we are embedding these principles.

Also in 2021, we plan to become signatories to the Principles of Responsible Investment (PRI) to further demonstrate our commitment to sustainability and increase transparency on our alignment with responsible investment principles, including stewardship. Embedding reporting against the principles into our advice and operations, including annual review of our investment beliefs, polices and activities, will take place alongside continuing to develop our alignment with the Stewardship Code 2020.

Rod Goodyer FIA

Partner and Head of Investment Consulting

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Please contact your Barnett Waddingham consultant if you would like to discuss any of the above topics in more detail. Alternatively contact us via the following:

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