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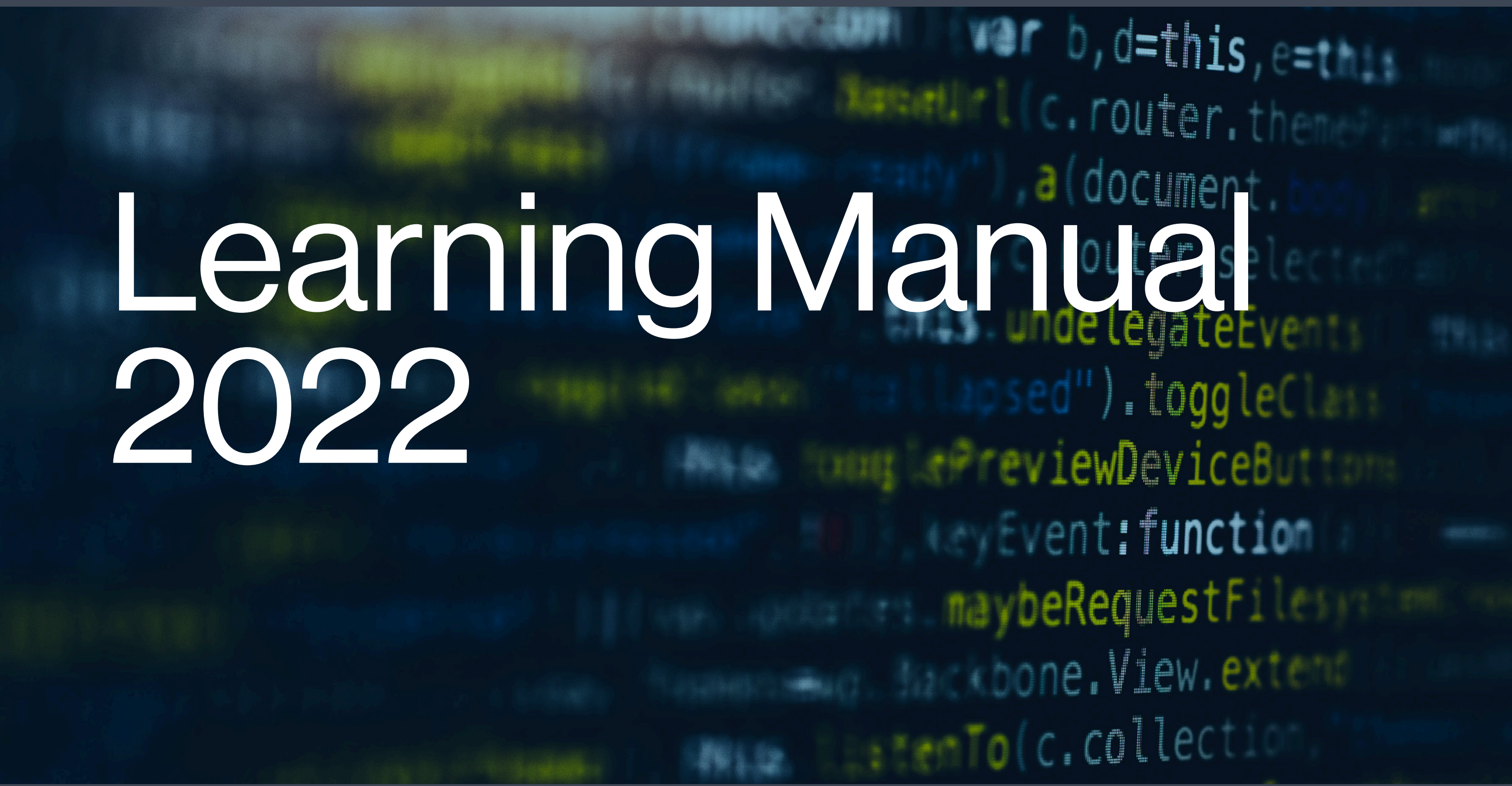

Learning Manual 2022

Why manager monitoring?

Pensions Management Institute
Moving pensions forward

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Introduction

Along with advancing reporting and legal requirements, the importance of external manager and fund monitoring keeps on growing thus posing new challenges for trustees and their consultants.

Already back in 2020, Guy Opperman MP, Minister for Pensions and Financial Inclusion, emphasized the role of monitoring and holding managers to account for their ESG risk management approaches and results:

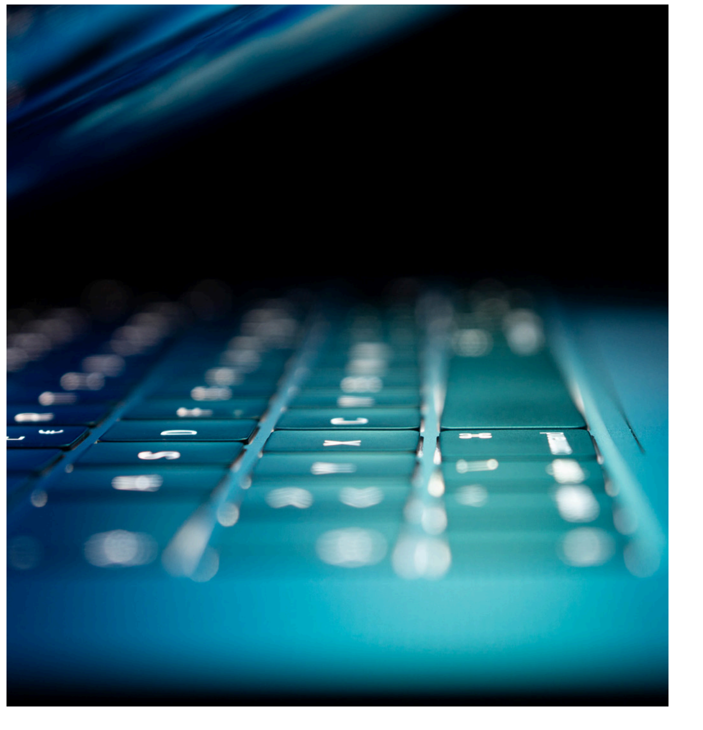
"You need intelligent, non-greenwash, verifiable answers from fund managers about what they are doing to manage those ESG risks. If you are not getting those you should dismiss them and move on to someone else. There is no question in my mind that this is not about divestment, this is about active management and about change for the greater good."

In August 2022, The Pensions Regulator (TPR) published the updated version of the Tender for Fiduciary Management Services Guide, confirming the essence of the latter quoted as a requirement: "After you have appointed an FMP, as part of a qualifying tender process, you should review the FMP's performance and periodically review the market to consider whether it is appropriate to run a re-tender exercise."

Furthermore, David Fairs, TPR's executive director emphasizes that this also refers to schemes' consultants:

"Robust monitoring of a scheme's financial advisers can influence the effectiveness of its investment outcomes and ensure it is following long-term plans. It also helps trustees ensure they are delivering value for money for savers." (IPE, 5 August 2022)

As the next section shows, the purposes of monitoring might differ while the process remains similar, thus simplifying the process for trustees selecting a profound monitoring approach to meet various requirements.



External manager and fund monitoring purposes

The monitoring process efficiency very much depends on the approach selected by the trustees and consultants, ideally applicable for various purposes, which in some cases enables combining them and thus reducing the input and effort on both, pension schemes' and investment managers' side.

Ongoing monitoring

One of the most common reasons for external- and fund- manager monitoring application cases is monitoring of the managers already selected as this is one of trustees' duties. Ongoing monitoring can be conducted on various levels (e.g. firm, fund, asset class) and combined with best practice recommendations (e.g. using PRI asset class level monitoring questionnaires or TPR/PLSA guideline-based templates).

The monitoring might also include a peer group review, particularly in cases of mid- and long-term engagements with managers. In case of ESG-focused monitoring projects, many pension schemes opt for an initial ESG status quo screening followed by further monitoring. It is typically based on a similar questionnaire which is being adapted by the issuer team according to the internal and legal requirements.

Statement of Investment Principles and **Investment Strategy Statement** implementation also very much depends on ongoing monitoring to ensure that the day to day asset management conducted by external investment managers is compliant with the relevant scheme statements. Trustees and consultants can develop a questionnaire template addressing the relevant topics and indicators to make sure the managers selected remain compliant and are aware of the expectations and requirements.

Stewardship and engagement are a core part of dealing with managers on both, investee and investment management firm level. Efficient monitoring of managers helps trustees identify issues that require engagement to avoid disqualification and retendering as further consequence. Furthermore, monitoring of managers' stewardship activities helps trustees assess the compliance of managers' approach, which is closely related to risk assessment-focused monitoring.

Risk assessment and management obviously also very much depend on an efficient and regular risk monitoring and includes ESG risk aspect as addressed by Guy Opperman in the previous section. The ESG focus includes legal requirements, as well as voluntary preferences set out in individual schemes' policies.

Information sourcing for reporting and disclosures is a process which can for efficiency reasons be combined with the regular monitoring and cover various topics, such as:

- Overall manager ESG approach
- Investment Paris-Alignment
- TCFD-alignment
- Net-Zero, climate change-related risks & opportunities
- Stewardship & engagement
- Nature-related financial risk assessment relevant data
- Equity, diversity and inclusion

External manager and fund monitoring purposes (cont)

Reviewing pension schemes own performance is another process that requires complex monitoring and enables holding schemes' external managers to account. This way monitoring is closely related to several other purposes.

Reporting, however, suffices as a single-purpose for monitoring and supports pension schemes meeting legal requirements on ESG, climate risk, stewardship and other topics. However, in many cases in order to increase the efficiency, a monitoring project can be set up to meet objectives based on various purposes. As Guy Opperman stated in 2021, "The UK is set to be the first major economy to require climate risk to be specifically considered and then reported on by pension schemes", which in this case includes monitoring for risk assessment and reporting purposes, while potentially indirectly overlapping with others.

Complementary information sourcing to assess value for money can be another purpose to regularly source, monitor and evaluate additional qualitative and quantitative data required to complete the relevant analysis.

Investment Consultant Sustainability Working Group (ICSWG-UK) good and best practice framework is based on the Guide for assessing climate competency of Investment Consultants and was prepared with input from TPR, PRI and ShareAction and sets out five themes, including Assessment of investment managers and engagement with them. The assessment requires profound monitoring of managers and enables consultants to demonstrate to pension schemes their climate competency, proficiency and best practice compliance.

[2] United National, Climate Change, Paris Agreement, 2022,
https://unfccc.int/process-and-meetings/the-paris-agreement/the-paris-agreement

Monitoring digitization as part of UK digital transformation

Due to advanced reporting, risk assessment and other legal requirements, investment manager monitoring requires reliable best practice aligned solutions to avoid implementation hurdles, which can be optimized by process digitization. However, digitization for digitization's sake can pose another inconvenience for its users, which is why user-friendly best practice implementation is essential.

Based on industry best practice the following requirements for a digitized monitoring process were suggested:

- digital technologies should enable an unbiased and instant access to an open asset manager universe, including for peer group review purposes, if required
- provide cost efficiency to support the value or money creation efforts
- make digital best practice implementation available to schemes independently from heir size and resources
- digitized monitoring should include optimized evaluation efficiency by digital scoring and weighting (the use of the latter recommended by TPR) tools and by providing the relevant calculations aggregated scores with integrated weightings) in a user-friendly way e.g. as an automatically calculated ranking for an optimized overview)
- enable full documentation to support the rationale behind decision making
- provide user-friendly tools to optimize the process of identifying issues requiring engagement or eventually disqualification

Conclusion

Monitoring is here to stay

Regulatory requirements, liability-, climate-related and other risks, as well as implementation of advancing best practice frameworks, will keep on challenging pension schemes, while remaining an important prerequisite for fulfilling trustees' fiduciary duties. Pension schemes need to rethink monitoring and consider efficiency increasing options to make sure their approaches and solutions are suitable and convenient enough to meet the advancing requirements.

Digitization as part of the UK digital transformation can support trustees in their work optimizing the monitoring process, however, it is essential to make sure it provides value added to the monitoring process, instead of turning out to be another task and hurdle for trustees. Combining user-friendly technologies, digitized best practice solutions set by authorities with a wide flexibility for schemes' specific requirements should be part of basic criteria for an efficient monitoring digitization process.

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