

Bill Galvin  
The Pensions Regulator  
Napier House  
Brighton BN1 4DW

3<sup>rd</sup> July 2009

Dear Bill,

When we spoke on the day of the Pensions Regulator Advisory Panel, you suggested I write a letter setting out some of FairPensions' ideas and evidence on Responsible Ownership. I hope very much you will find this contribution a helpful one.

**FairPensions**

By way of background, we are a registered charity focused on the promotion of responsible investment by institutional investors, particularly pension funds and the fund managers who serve them. We focus on encouraging good governance, transparency and accountability throughout the investment chain. Our work, including our research, is informed by growing evidence that responsible and engaged ownership of assets by pension providers delivers stronger returns for beneficiaries over the long term. Furthermore responsible ownership leads to responsible corporate behaviour which is also likely to be in the interest of members as citizens and consumers, and indeed of society more broadly.

My own thinking is informed by my experience over the last 18 months as a Member Nominated Trustee Director of The Pensions Trust, a multi-employer pension fund with over 130,000 DB and DC members in the UK's charitable, social, educational and not-for-profit sectors.

FairPensions' definition of responsible investment places fiduciary duty to members front and central. Responsible investment (RI) recognises that environmental, social and corporate governance (ESG) factors can be material to shareholder value, and as such requires these factors to be assessed and integrated into research and investment decisions. It involves active, considered voting of shareholdings as well as engagement with companies where risks, including ESG risks, have been identified.

To effectively manage ESG risks and opportunities on behalf of members, pension schemes and their managers need transparent policies, implementation procedures, and performance monitoring. FairPensions has undertaken research during the last 12 months to assess whether such policies, procedures and monitoring are in

place. Although our research was limited to the UK's 30 largest occupational pension schemes and the 30 largest asset managers used by schemes in the UK, we believe it offers evidence which is relevant to the industry more broadly.

Our findings demonstrate that responsible investment is rising up the agenda of both pension schemes and of fund managers. This is positive news for members and, we believe, for society more broadly. However the overall picture is one of huge variability in the attention given to responsible ownership both at scheme level and amongst managers employed to invest on behalf of schemes.(1) A key finding of our work is that whilst schemes almost universally recognise the materiality of ESG risks in their Statements of Investment Principles, in practice this is frequently not followed up with the requisite necessary policies and practices to manage such risks effectively.

All our research is available free on our website. More recently FairPensions has developed a Responsible Investment self-assessment tool for pension schemes, based on the questionnaire used in our 2008 survey of the UK's 30 largest occupational schemes. We would be pleased to make this tool available to the IGG.

### **IGG Membership**

FairPensions commends the terms of reference of the IGG. We are pleased that a dedicated group has been established to focus on the Myners Principles, and we look forward to the outputs which will emerge from the IGG as well as the outcome in terms of stronger governance of pension schemes and their investments. (2)

We believe that membership of the IGG should be broadened further. In particular we think it is important that members of pension schemes be more strongly and visibly represented going forward, through the inclusion on the IGG both of experienced MNTs/MNDs and other civil society organisations which champion the interests of scheme beneficiaries.

### **Responsible Ownership: Members and Agents**

A strong theme coming out of the 2008 review of the Myners Principles was the need for 'industry ownership' of the revised principles and their implementation. Whilst we acknowledge the importance of industry involvement, it needs to be recognised that at times the interests of the 'industry', particularly the fund management industry, may diverge from those of scheme members.

---

(1) Our Pension Scheme Survey is at: [http://www.fairpensions.org.uk/fairpensions\\_pdf/ResponsiblePensions\\_2009.pdf](http://www.fairpensions.org.uk/fairpensions_pdf/ResponsiblePensions_2009.pdf)  
Our Fund Manager Survey is at: [http://www.fairpensions.org.uk/fairpensions\\_pdf/FundManagerRanking08.pdf](http://www.fairpensions.org.uk/fairpensions_pdf/FundManagerRanking08.pdf)

(2) Evidence of the positive financial impact of good scheme governance is increasingly emerging. A significant study in the Rotman International Journal of Pension Management in 2008 found that better governed pension funds outperformed poorly governed funds by 2.4% pa during the four years ending December 2003. - Capelle, Ronald, Lum, Hubert and Ambachtsheer, Keith, "The Pension Governance Deficit: Still with Us," (October 1, 2008). <http://ssrn.com/abstract=1280907>.

This is most obviously true in respect of fees charged for investment management. However conflicts can also be identified in relation to the effort required to effectively manage environmental, social and corporate governance risks. In many instances these are risks which may impact financial value over the medium and long-term. As such members, particularly younger members, have a strong interest in them. However fund managers employed on mandates of short duration do not share the same obvious financial incentive to proactively manage risks which may trigger costs for beneficiaries in the longer term.

This is not to downplay the fact that even in the short term members may suffer when fund managers neglect to undertake the basic elements of responsible ownership. Voting is a good example. The recently published TUC survey of fund managers' voting records found that less than 75% of respondents (with a less than 40% response rate from the industry) make voting data available but there are considerable variations in the level and quality of disclosures. A number of managers which do not disclose their voting records do not provide a statement explaining their lack of disclosure, as recommended by the Institutional Shareholders Committee. The TUC's survey demonstrates a clear divide amongst fund managers in their willingness to challenge investee company management. At one end of the spectrum, eight respondents to the survey supported over 90% of management proposals on which voting decisions were sought. At the other end six respondents supported less than 50% of management proposals. Only a single manager in the sample – Co-operative Insurance Society – opposed the RBS acquisition of ABN Amro. This data suggests that the fund management industry has some way to go in making use of the vote to protect the financial interests of scheme beneficiaries. In this context FairPensions applauds the work being undertaken by the ISC and its constituent bodies to take forward the responsible ownership agenda in the wake of the 2008 financial crisis.

FairPensions is particularly concerned about the vulnerability of DC members in relation to responsible ownership. In assuming all the investment risk, DC members depend upon investment managers to robustly and effectively manage factors which could reduce the financial sustainability of investee companies. Whilst there are some truly excellent fund managers in the UK whose practice as responsible investors is exemplary, far too many DC scheme members have their funds managed by institutions which research by FairPensions and others has shown to be careless at best. In this regard we are very pleased to see that the IGG has a dedicated stream focused on DC members. We suggest it may be important to have the IMA's leadership on this project complemented by other players who only have beneficiaries' financial interests at heart.

### **Trustee Education on Responsible Ownership**

Having been elected onto a pension scheme board relatively recently, I found the Regulator's Trustee Toolkit to be an invaluable resource in developing relevant knowledge and understanding in my first year as a trustee. In my view, completing the Trustee Toolkit or equivalent is the very minimum trustees should do to reassure members of their competency to fulfill fiduciary obligations.

FairPensions believes that in the period ahead the Trustee Toolkit as well as the guidance for schemes coming out of The Pensions Regulator could be strengthened with regard to responsible ownership. We were pleased that the NAPF recently published guidance on Responsible Investment. This is a key area for the IGG to work on in the period ahead. FairPensions would be pleased to assist in any way.

It is a requirement of Statutory Instrument 2005 No 3378 that trustees must state in their Statement of Investment Principles, ‘the extent (if at all) to which social, environmental or ethical considerations are taken into account in the selection, retention and realisation of investments’ and ‘their policy (if any) in relation to the exercise of the rights (including voting rights) attaching to the investments.’

In practice, trustees cannot disclose what consideration they give, if any, to ‘extra-financial’ factors in the investment process without a proper understanding of why and in what circumstances such considerations could have a material impact upon investment performance. TKU guidance should assist trustees in gaining this necessary understanding and in keeping up to date with relevant developments.

In 2005, the UNEP Finance Initiative commissioned from law firm Freshfields Bruckhaus Deringer a study entitled, “A Legal Framework for the Integration of Environmental, Social and Governance Issues into Institutional Investment”. (3) The analysis of fiduciary obligation developed in the report is as follows: “It is not a breach of fiduciary duties per se to have regard to ESG considerations whilst pursuing the purposes of the trust. Rather, in our opinion, it may be a breach of fiduciary duties to fail to take account of ESG considerations that are relevant and to give them appropriate weight, bearing in mind that some important economic analysts and leading financial institutions are satisfied that a strong link between good ESG performance and good financial performance exists.”

The existence and considerable international influence of this legal opinion has changed the context in which UK trustees now make decisions. If, as stated, it may be a breach of fiduciary duty for trustees to ignore material ESG considerations, they must clearly understand the implications if their fund managers are not explicitly mandated to integrate ESG considerations into the investment process. It is possible that in the future, for example in DC schemes where investment returns turn out to be poor, scheme beneficiaries could challenge trustees who were poorly informed, or even willfully dismissive, of considerations which turned out to have a material impact on long-term investment returns.

In this context it may be important for the Regulator’s guidance to properly encourage trustees to understand both the material risks to investment returns which can be associated with companies’ handling of extra financial factors, and the risk to trustees themselves if they inadvertently act in breach of their own fiduciary duties by ignoring these factors in the investment process.

---

3 [http://www.fairpensions.org.uk/pdf/freshfields\\_legal\\_resp\\_20051123.pdf](http://www.fairpensions.org.uk/pdf/freshfields_legal_resp_20051123.pdf).

## Disclosure and Transparency

Principle 6 of the Revised Myners Principles focuses on Transparency and Reporting. Without transparency members are unable to assess whether effective decisions are being made on their behalf. Given the investment risks which DC members face, transparency is particularly critical for DC schemes. (4)

FairPensions has researched the transparency of both investment managers and pension schemes (focused in both cases to the 30 largest schemes and managers by AUM). Overall, our research finds that institutional investor transparency is improving but varies significantly and is on average somewhat below the level that members are entitled to expect of institutions investing their retirement savings. FairPensions believes that much could be done to accelerate this positive existing trend. A clear steer from the IGG would help. Again, a greater presence of scheme members, their representatives and their champions, on the IGG would almost certainly be valuable in keeping this important issue under review.

In FairPensions' surveys we found that investors which were more transparent also had more robust and effective policies in place to manage and monitor ESG risks. It is particularly interesting to note that local government pension schemes which operate under more stringent transparency requirements (for example they are subject to Freedom of Information legislation) also demonstrate on average stronger RI policies and practices on average compared to private sector trust-based schemes. This does suggest that the interests of scheme members might be better served by stronger and clearer regulations on transparency and disclosure, as opposed to guidance.

In conclusion, FairPensions is pleased to have been asked to make a contribution to the IGG and Pensions Regulator's work on Responsible Ownership. We hope to continue a dialogue on the various matters raised in this letter and on the overall workplan of the IGG. We believe these issues are critical for the future well-being of working people saving toward their retirement, and that getting them right will have many wider positive repercussions for companies and society as a whole.

I would be pleased to follow up on any issues raised by this letter.

Yours sincerely,

Catherine Howarth  
Executive Director

---

<sup>4</sup> FairPensions recently submitted a detailed response to the DWP's consultation on disclosure regulations for UK pension schemes setting out both the case for more robust disclosure regulations and some suggestions for how this might be achieved at low cost.