

UKSIF Annual Lecture and AGM 2003

Thursday 6 Oct 2003

Brendan Barber, the General Secretary of the Trades Union Congress, who has a keen interest in pension fund investment and the role of union-backed Member Nominated Trustees, gave this year's Annual Lecture (full text below). The Lecture was followed by responses from Clare Brook, Morley Fund Management, and Peter Montagnon, Association of British Insurers, a brief question and answer session, and a networking reception.



The event, which was sponsored by Morley Fund Management and supported by the Corporation of London, was held at The Guildhall in the City in the early evening.

Earlier in the day, UKSIF held its 12th Annual General Meeting (for members), and informal workshops (for members and affiliates) on the following topics:

- UKSIF's *Retail Revolution*
- *Just Pensions*
- Collaborative Engagement Support

Brendan Barber
General Secretary, TUC
UKSIF Annual Lecture 2003

I would like to start by thanking the UK Social Investment Forum for inviting me to speak this evening.

As many of you will be aware, institutional investment is new territory for the TUC, and I very much welcome the opportunity to outline some of our thinking in this area.

There are three key issues I'd like to discuss this evening:

1. Why an investment process driven solely by returns is economically and socially counter-productive;
2. How we now have a real opportunity to change the way we invest for the better; and
3. What the union movement is doing towards this end.



Let's begin with a question. Why do pension funds exist?

A minimalist definition might say to generate an income in retirement. A broader definition is to help people save for and enjoy a reasonable lifestyle in retirement.

But how do pension funds meet that broad objective when they invest?

How many of us in this room, I wonder, have been on the receiving end of a lecture on the need to focus solely on returns, and how we must not let non-financial factors cloud our judgment?

The business of pension fund investment, we are told, is purely to generate income. No judgments need be made about the nature of the companies and assets invested in, or the impact the investment has.

As is usually the case with conventional thinking on issues, there is a sound principle here. It would be hugely irresponsible to claim that it doesn't matter whether investments generate adequate returns, and ultimately income for beneficiaries, provided they fulfill a wider social purpose. Such an outlook would mean that the function of the pension fund was being subverted.

But historically the pensions industry has made it almost a point of principle that the reverse is true – it doesn't matter how the companies we invest in behave, or how they are run, provided they generate a decent return.

This is an attitude that I believe is just as subversive as the first. The flaw in taking such a narrow view is that it too risks undermining the fundamental function of the pension scheme. It does this in two ways.

Firstly and most obviously, beneficiaries – those for whom the pension fund exists, and on whose behalf investments are made – do not inhabit a theoretical bubble or a moral vacuum. The society they live in is the same society the companies they invest in help create.

They see, feel – and sometimes suffer – the actions of these companies.

Yes, companies have a responsibility – a social responsibility – to make a profit. We want well-run, profitable companies because they help fund our retirement over the long term, as well as creating wealth and employment.

But members of pension schemes do not want to create a society where some companies can:

- pollute and destroy the environment;
- mistreat their employees;
- or turn a blind eye to human and labour rights abuses.

Tolerating poor standards might make sense within a narrow conception of investment and return, but beneficiaries feel the cost in a wider sense.

For they are members of a less just society and sometimes employees of the firms that help create it.

And by the way if you are not convinced that pensioners take a close interest in such issues, I am more than happy to share some of the TUC's bulging mailbag from retired union members!

The second problem is that taking a hands-off approach can allow companies to go off the rails, and that ultimately destroys value.

The risks from allowing governance failings to go unchecked are well-documented. And many would argue that poorly-governed and socially irresponsible companies may already trade at a discount.

A report in the Financial Times in July noted that the type of companies that find it easier to get into socially responsible investment indexes have higher price to earnings ratios than those exposed to corporate social responsibility risks.

And Hermes succinctly summed up the case for investors taking a closer interest in corporate governance in its review of recent research.

But let me put in context where I think a hands-off approach to ownership leaves us.

Bernie Ebbers famously had a response for dealing with analysts' queries about how he ran WorldCom. He used to point at a chart of the company's then soaring share price. The message was blunt: if you are getting the returns, what else do you need to be bothered about?

Well hasn't the attitude of much of the pensions industry to corporate governance and social responsibility been much the same, but on a larger scale?

It too has been guilty of pointing at charts by way of deflecting questions about ownership, only the charts have CAPS or The WM Company written on them.

It is an attitude doomed to fail, as three years of a bear market and a series of corporate scandals and implosions attest.

Pension funds have lost tens of billions of pounds, causing huge funding problems and leading many employers to take a short-term view and close defined benefit schemes.

This brings me nicely onto my second main theme – if there is a silver lining to the cloud, the collapse in share prices has created a window of opportunity for a more responsible share-ownership culture to emerge. Investor attention is focused as never before on the way companies are run.

In addition, there is a clear desire from government for a change in approach. There is a thread running through recent government initiatives – from the July 2000 amendment to the Pensions Act, to the Myners review, to the Company Law Review – that can only be read as encouraging a wider view of companies and the role their owners play.

In the TUC's view, to use a well-worn phrase, it is time for investors to start acting more like owners and less like traders. Indeed everybody involved in the business of institutional investment should raise their game.

We know as trade unionists we have a responsibility to bear. Many of us are pension fund trustees. We take seriously the analysis provided by Paul Myners of failings within institutional investment, and are prepared to act.

We plan to develop training to increase trustee knowledge of investment issues and the responsibilities of ownership.

In turn, the fund management industry's response has been to encourage self-regulation.

The Institutional Shareholders Committee produced a set of principles last year on the responsibilities of shareholders.

Broadly they include the need for investors to

- have clear policies on how they discharge ownership;
- intervene in companies where necessary;
- and to set out ground-rules on reporting back to clients.

Endorsed by the key industry bodies representing institutional investors, these principles form a useful framework. And if all investors were willing to follow them, we believe that there could be genuine change.

But – moving onto my third and main theme – we in the union movement feel more needs to be done.

The TUC is a little sceptical about the impact of the ISC principles so far.

A year on, feedback from our trustees suggests they are often absent at various stages of the investment process.

With limited exceptions, and we hope this changes over time, the principles are not appearing in tenders or in investment management agreements.

But more importantly have fund managers' attitudes changed?

Over the summer the head of Citigroup's investment management business pointedly dismissed shareholder activism, in part because other investors could benefit without putting in any effort themselves.

And only last week Professional Pensions magazine reported on one of the newest entrants to the fund management industry, whose response to failing companies was to "sell out as fast as possible".

Guiding companies by voting shares was implied to be a waste of time, and fund managers had a "legal and moral duty" to disinvest from failing firms.

This might be at one extreme of the debate, but such comments fuel the view that there is still little appetite among many large investors to take the responsibilities of ownership seriously.

I should stress that we are trying to help embed the ISC principles. The TUC distributed copies of the principles to over 1,000 member-nominated trustees and, as I said before, we will promote them in trustee training.

We believe the principles must be made to bite. We understand the industry's antipathy towards legislation, and we will endeavour to try and make self-regulation work.

But if that does not happen, we will make clear the initiative has failed and should not be allowed to persist as a fig leaf for inaction. I remain hopeful, however, that if we make a concerted effort it will not come to that.

Issues such as the impact of the ISC principles, and the wider debates created by Myners, suggest that unions have a key role to play in addressing some of the failings in the investment process as it currently exists.

One message we have received loud and clear from the fund management industry is that while active ownership is an interesting proposition, until there is client demand, it remains merely an aspiration.

Although a number of managers are taking a more active stance, we sense that commercial reality remains the driver for many. Perhaps Citigroup was only saying out loud what many think in private.

This means trustees must try to counter the "free rider" issue. At present it is too easy for fund managers to have a reasonable-sounding policy, without it leading to practical activity. Uncommitted managers can free-ride off those who put resources and effort into ownership.

This was one of the spurs behind our recent survey of voting by institutional investors. We say that if it is necessary to provide commercial incentives for managers to pursue activism, then trustees need more information.

Voting records may only tell part of the story, but they do provide a useful indication of how different managers approach issues. And more importantly, the information is quantifiable and cannot be hidden behind vague statements of policy.

It would be an understatement to say that the survey prompted controversy. But I wonder, with a few months distance, what the views are now.

For our part I should add it was not lost on us which types of investors were willing to volunteer information. There has been talk of the coming together of corporate governance and socially responsible investment. It was striking that investors with a reputation for activism of both kinds were much more willing to disclose.

Going further, we believe the argument for more active ownership is particularly strong for pension funds with passive portfolios. Tracking an index means by definition that the fund is locked into certain stocks. They cannot trade their way out of trouble.

The TUC's view therefore is that trustees appointing passive mandates must take a close look at the resources managers devote to addressing governance and CSR issues. They

should appoint managers that are committed to defending and enhancing value through active ownership. And this should be one of the key differentiators at the beauty parade.

Of course, there is an equal case to be made when choosing active managers. But the particular nature of passive investment does throw the responsibilities of ownership into sharp relief.

More broadly, unions in the UK are also trying to practice what they preach. For example, the TUC has called on investors to disclose voting records. To be consistent with our public policy, the TUC staff pension fund now discloses its voting record.

Unison has recently decided to assign the majority of its pension fund's assets to a socially responsible investment mandate. I'm sure other unions will begin to look more closely at the way they invest their assets.

These are initial forays into the field of institutional investment, but they mark the beginning of a serious commitment by unions to responsible stewardship of the huge pools of capital created by our funded pensions system.

I won't pretend there is no resistance to the message unions are beginning to articulate. There is, and it is often forcefully put across.

The arguments for conservatism will no doubt be familiar. Investors shouldn't rock the boat and risk destabilizing companies. Taking a more activist stance is legally difficult. And being more open will allow pressure groups undue influence.

These types of arguments resurface regularly – they have been used against the July 2000 amendment to the Pensions Act, the Myners recommendations on activism, the directors' remuneration reporting regulations, Higgs and so on.

No doubt there will always be plausible-sounding arguments in favour of inaction, and dire predictions of the dangers of straying from the way things have always been done.

But I hope many of you will agree a more responsible investment culture is the right path to follow. The investment of hundreds of billions of pounds of retirement savings is a matter of huge social and economic importance. The argument that there is no public interest in the way investors discharge ownership sounds increasingly hollow.

There are signs that things are slowly changing. In the Just Pensions survey carried out of our Member Trustees Network last year there were clear indications that trustees believe corporate governance and social responsibility have an impact on the bottom line.

We are currently working with Just Pensions on a follow-up survey – initial results are encouraging.

For example, many trustees expect their funds to put more effort into exercising ownership over the coming years. Engagement with companies and the more effective use of voting rights are the tools they are most likely to employ.

But we should not be too wide-eyed. The results also suggest there are still barriers to growth in responsible investing.

The biggest is uncertainty about the financial benefits of becoming more active.

Trustees are also held back by the possible extra costs, and some have had doubts placed in their minds about the legitimacy of such initiatives from their consultants and legal advisers.

But overall the emergence of a trend is clearly there.

And let's not forget how quickly yesterday's heresy can become today's mainstream opinion.

Ten years ago PIRC was portrayed as pursuing a radical agenda.

Now much of what PIRC said in the past is in the DNA of UK corporate governance. Back then many fund managers did not even vote, now the large majority do, and many try and vote intelligently rather than routinely supporting management.

Five years ago the Universities Superannuation Scheme seemed firmly in the sceptical camp on socially responsible investment. Now it is amongst the leading responsible investors worldwide.

Today we are told that pension funds and other investors generally don't want to exercise their ownership more actively, and that more responsible investing will never seriously take off.

When we look back in five or ten years time I wonder who will have been right? I think the answer will depend in no small way on the foundations that are laid now.

To progress, all of us have to abandon some of our preconceptions. Clearly it is wrong to characterize companies as simply rapacious, amoral profit-engines; they are also social institutions that generate wealth and employment, not least for trade union members.

We do not believe all directors are fat cats; most are striving to do the right thing in a challenging environment.

But in turn it must also be recognised that concerns about corporate behaviour – expressed by employees, communities or investors – need to be heeded.

Business needs legitimacy to survive. And owners who do not step in when things go wrong fail all of us. It is in no-one's interest that businesses are left to become financial or social basket cases.

To date, the move towards a more active share-ownership culture has been largely the work of people in this room – the activist and socially responsible investors. You have opened a path for others to follow.

It is now time for trade unions to pick up the baton. It is often our members' money that is being invested and, arguably more importantly, we have a unique role given that many trade unionists are pension fund trustees.

So if I have a message to leave you with, it is this – that trade unions will try and play our part in developing a responsible investment culture. We will endeavour to use our financial assets actively to ensure that companies are well-run and responsive to questions of social responsibility.

After all, our pensions – and our futures – depend on it.

Thank you.

Questions and answers...

*...from Brendan Barber, and respondents
Clare Brook, Morley Fund Management, and
Peter Montagnon, Association of British Insurers*

