

A Viewpoint on Pension Funds and Ethics

This article by Penny Shepherd, Executive Director of the UK Social Investment Forum, was published as a guest feature in the 1999 Winter Bulletin of the Investment Committee of the National Association of Pension Funds. In publishing it, the NAPF's Investment Committee highlighted that it reflected the view of the UK Social Investment Forum rather than that of the NAPF's Investment Committee.

The UK Social Investment Forum is the UK's network for ethical, green, and socially directed investment. Its primary purpose is to promote and encourage the development and positive impact of socially responsible investment throughout the UK. Founded in 1991, its members include financial institutions, independent financial advisers, social finance organisations, NGOs, community-based organisations and concerned individuals. It provides the secretariat for the All-Party Parliamentary Group on Socially Responsible Investment launched in early 1998.

John Denham's proposals for the disclosure of ethical investment policies by occupational pension funds should support occupational pensions in maintaining their relevance in the millennial marketplace. If the pensions industry responds positively, ethical investment will not remain a benefit available only with other forms of pension provision.

Delivering the UK Social Investment Forum [Annual Lecture last July](#), Denham said that he was "minded to require trustees to disclose to what extent, if any, they have taken account of social and ethical considerations in their investment strategy". We anticipate that, subject to consultation, the associated regulation on disclosure in the Statement of Investment Principles will be in place in Spring 1999 with time for training and planning afterwards before it comes into force.

Ethical Investment

Ethical investment means exercising responsibility as investors for the social and environmental consequences of wealth creation. It covers much more than just stock exclusion or "negative screening". It embraces also positive stock selection, shareholder influence and socially responsible venture capital and property investment.

In the US, the term "ethical" is not used. Instead they talk of "socially responsible investment" (SRI). But here "ethical" has become established as the term to describe the

range of ethical, social, environmental and value-based concerns which motivate the active citizen or "ethical consumer". For business, "social" can seem a more comfortable umbrella term, so we have "social auditing" and indeed, copying the name of our US sister organisation, the UK Social Investment Forum.

Approaches to Ethical Pensions

Pension fund trustees may approach ethical pensions in a variety of ways. I see three linked approaches in the current debate - "performance", "added value" and "total future".

The "**performance**" view looks at the links between financial performance and social and environmental performance. It concludes that, as long-term investors, pension funds should be concerned about these links in order to maximise return over a timespan stretching decades into the next century.

The "**added value**" view considers the ethical concerns of the beneficiaries and wishes to deliver financial return in the way most consistent with their values, within the limits of legal constraints.

The "**total future**" view takes account of the total return to beneficiaries from the consequences of pension investment. One example is given by Tony Juniper, Policy and Campaigns Director of Friends of the Earth. Quoting recent scientific evidence, he queries whether the pensions industry can claim to deliver the best financial return to someone in East Anglia who, decades into the next century, receives the income promised but has the value of their other major asset, their house, destroyed by climate change.

Initial Strategies

The initial steps taken by trustees will tend to depend on the approach adopted. Many may test beneficiary views - for example by introducing a properly promoted ethical investment AVC. Others will start to assess investment managers on their ability to use social and environmental performance in their stock selection strategies. Many will seek to use shareholder influence to improve the environmental and social performance of their investments. Geof Pearson of the Sainsburys Pension Fund has highlighted its intention to address environmental performance using both stock selection and shareholder influence.

Specialist service providers are already responding. The Ethical Investment Research Service (EIRIS) has long been the primary provider of services for stock exclusion. In their latest Annual Review, they highlight the growing emphasis in their research on providing information about behaviour which investors might wish to encourage rather

than avoid. They are undertaking a wide-ranging review of their services in order to respond effectively to market changes. Meanwhile, corporate social responsibility and environmental performance offerings are being introduced by leading corporate governance services.

For well over a decade, local authority pension funds have invested in local venture capital for sustainable job creation as part of a diversified strategy. Regional investment specialists are seeking to encourage private sector funds to consider this option for social and financial returns. A debate is emerging on more socially responsible approaches to property investment.

And, of course, there remains a clear role for stock exclusion as part of an ethical investment strategy. A growing number of US public sector pension funds exclude tobacco stocks, concluding that here a "best of sector" or shareholder influence approach is not appropriate.

Legal Issues

In his speech, John Denham highlighted the view of the Goode Committee that trustees were perfectly entitled to have a policy on ethical investment and to pursue that policy so long as they treat the interests of the beneficiaries as paramount and the investment policy was consistent with the standards of care and prudence required by law. He urged advisers to address the challenge of providing advice to those of their clients who wished to follow the approach set out in the Goode Report.

Leading advisers are starting to respond to his call. Such guidance is essential to advancing the agenda. After all, the 1995 Pensions Act post-dates what past legal cases exist and there is no case law on ethical investment by a private sector corporate pension fund.

Some are concerned that the government may go further and require compulsory ethical investment. In my view, such concerns are groundless. This government will not force pension funds to invest ethically. Their approach is to encourage and enable.

So what future changes might we see to pensions law? I believe that further change is indeed necessary. While John Denham's disclosure proposals are a welcome first step, they are unlikely to enable trustees to meet fully the wishes of beneficiaries. Less than forty years ago, pension funds owned only a small part of UK plc. It is not surprising that the legal framework should have to evolve to allow pension funds to address the responsibilities following from their greater power. This is why I hope that the pensions industry, as well as debating how best to address disclosure, will consider actively how the underlying legal framework can be improved to enable occupational pension funds to address most effectively their social responsibilities.

Steps towards Ethical Pensions

- Introduce an **ethical investment AVC** and assess take-up
- Develop a **policy** for integrating the ethical, social and environmental dimension into your investment strategy. Consider the "performance", "added value" and "total future" approaches.
- **Assess your investment managers** on their ability to take social and environmental performance into account in stock selection and to influence companies towards best practice; ensure that they don't act counter to long-term corporate social responsibility. When you consider changing investment managers, include these aspects in your criteria. Ensure that your professional advisers can make informed recommendations on ethical investment.
- Exercise your **voting power** to encourage responsible behaviour; specialist services can help.
- **Review your portfolio** for unacceptable stocks and exclude the very worst, or follow the example of leading local authority pension funds by investing a small percentage of your pension fund ethically and assessing the resulting performance; always take professional advice first on performance and other implications
- Integrate the social, ethical and environmental dimension into your **venture capital and property investments** as well as your equities and bonds.

(adapted by the UK Social Investment Forum from recommendations developed by the Ethical Investment Research Service (EIRIS).)