JUST**PENSIONS**

WILL UK PENSION FUNDS BECOME MORE RESPONSIBLE?

A SURVEY OF TRUSTEES

2006 EDITION

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JUSTPENSIONS

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1. FOREWORD

I warmly welcome this, the third study of pension fund trustees' attitudes to socially responsible investment (SRI). I am encouraged that the report shows more trustees than ever before considering these issues as part of their investment strategy.

As Pensions Minister in 1999, I introduced the regulation requiring pension schemes to disclose the extent, if any, to which they take social, ethical and environmental issues into account in their investment strategy[1]. It was light touch legislation, designed to promote cultural change. The survey provides encouraging evidence about the extent of progress in the past seven years.

Pension professionals have traditionally been wary of SRI. Their doubts have been fuelled by a distorted view of the Cowan vs Scargill case some twenty years ago. The legal profession is conducting a welcome re-appraisal of this case. Indeed, the recent Freshfields report concluded that trustees may be in breach of their fiduciary duty if they do not take into account social, environmental and governance issues[2]. If this view prevails, it will give even greater impetus to the shift in favour of SRI.

I remain as keen as ever to promote SRI. It is the right thing to do, and it also adds value. With a new generation embracing "Make Poverty History"[3] with the exuberance we saw last year, market demand for a socially responsible approach can only continue to grow.

I am cautious about proposals for new regulation. Pension funds already bear a large regulatory burden, and the associated costs, and we are looking at what we can do to reduce them. We should look first to achieving our aims through market based mechanisms, greater voluntary disclosure and continuing cultural change.

I am delighted that UKSIF – which has already achieved so much – will continue to take the initiative, launching its new Sustainable Pensions programme to inform trustees and others. I look forward to following its progress.

Stephen Timms
Minister of State for Pensions Reform
Department for Work and Pensions (DWP)

[1] HMSO (1999) The Occupational Pension Schemes Amendment Regulations 1999: Statutory Instrument 1999 No. 1849: www.legislation.hmso.gov.uk/si/si1999/19991849.htm.
[2] Freshfields / UNEP Finance Initiative (2005) A Legal Framework for the Integration of Environmental, Social and Governance Issues into Institutional Investment: www.unepfi.org/fileadmin/documents/freshfields_legal_resp_20051123.pdf.
[3] Make Poverty History: www.makepovertyhistory.org.

2. SUMMARY OF SURVEY FINDINGS

The research described in this report casts light on the drivers and barriers to the further adoption of socially responsible investment (SRI) by UK pension funds. This is the third study exploring these issues conducted by Ashridge in association with Just Pensions. A total of 79 UK pension fund trustees responded to the survey between October and the beginning of December 2005.

Trustees were asked about:

- Their views of the current and future importance of social, ethical and environmental (SEE) issues in investment practice – including both drivers and barriers to the growth of SRI.
- How these issues are impacting on current investment practices and how these might change over time.
- The appropriate role of Government in encouraging greater engagement and integration of SEE issues in the investment practices of UK pension funds.

Trustees were asked to what extent six areas of corporate behaviour would impact on the market value of the FTSE100 in both the short (1 year) and longer (5-10 years) terms. For the purpose of this research, the six issues listed below constituted responsible corporate behaviour and so the basis of SRI. The key findings are:

1. **"Quality of customer relations"** is ranked as the most significant issue in the short term and first equal in the longer term. The proportion of those who believe that this area will have a substantial impact in the longer term has gone from 38% in 2003 to 43% in 2005.

2. **"Good corporate governance"** is viewed as the second most significant issue in the short term and first equal in the longer term. A quarter (26%) of trustees thought it would have a substantial positive impact on the market value of quoted companies within one year and this figure increased to 43% when asked to consider the next 5-10 years. In the longer term nearly nine in ten (86%) thought it would have at least some positive impact.

3. **"Effective environmental management"** is seen as having at least some impact in the short term by 58% of trustees. Longer term nearly nine in ten thought it would have at least some impact. Comparing the findings with the 2003 results identified it as the fasting rising issue in terms of having a substantial positive impact.

4. **"Good employment practices"** is viewed as having at least some positive impact in the longer term by eight in ten trustees, with one in four believing that it would have a substantial impact.

5. **"Communication and transparency on social and environmental practices"** is seen as having at least some positive impact in the longer term by eight out of ten trustees.

6. **"Respect for local needs in the developing world"** has increased substantially in importance. In 2003 just over half of trustees believed that it would have at least some positive impact in the longer term. In 2005 this figure increased to over three quarters. However it is seen as the issue least likely to have a positive impact on market value in either the short or longer terms.

Only about one in ten trustees believe that companies are providing sufficient information to enable social and environmental impacts and risks to be assessed effectively. Trustees also identified a host of barriers to further integration of SEE issues. Most of these can be seen as clustering around two contentious issues – cost versus benefit and the quality of current evaluation tools. Trustees from different sized pension funds did however differ as to the importance they placed on the barriers for their fund. For the largest funds the most commonly cited barrier of great significance was uncertainty as to the financial benefits. Trustees from four in ten of the largest funds identified this uncertainty as of great significance. In contrast for the smallest funds concerns raised by legal or investment advice was the barrier most commonly cited as having great significance (28%).

Despite these barriers, there is however a strong belief that engagement will lead to improvements in the way companies manage impacts and risks in these areas – particularly in the longer term. Nine out of ten trustees believe that shareholder activism will lead to at least some improvements in the next ten years and nearly half of trustees (45%) believe that the improvements will be substantial.

The research also found considerable changes have occurred in investment practice since 2003. The use of negative screening appears to have increased considerably. In 2003 only 2% of respondents said their fund was using it a lot compared with 11% in 2005 – a fivefold increase. Engaging with investee companies to encourage better performance also appears to have increased considerably. In 2003 only 26% of respondents reported that their fund was using it a lot compared with 40% in 2005.

Trustees were also asked about how the investment practices of their funds will change over the next three years. While the use of screening will increase the biggest changes among UK pension funds will be the substantial increases in both engagement with investee companies and in exercising voting rights. It seems that trustees favour the various forms of engagement over screening as a way to implement SRI. This finding is strongly in accord with the findings from the 2003 survey.

Many trustees believe that Government has an important role to play in encouraging the incorporation of SEE issues into investment practice. As with the 2003 survey, the majority of trustees in 2005 believe that:

- Additional regulation or legislation is needed to require pension funds to report on the implementation of their Statement of Investment Principles (SIPs) in their report and accounts.
- It should be a legal requirement for defined contribution schemes in the UK to offer an "ethical" option.
- The UK Government should promote a formal code of best practice for pension funds in dealing with social, ethical and environmental issues.
- There is a need for legislation or regulation by the UK Government to encourage a longer term perspective in equity investment.

3. FULL SURVEY REPORT
3.1. INTRODUCTION

Background to the Research
This survey is the third survey of pension fund trustees' attitudes to SRI conducted by Ashridge in conjunction with Just Pensions. Research presented here builds on the findings from the 2002 and 2003[4] surveys. Three broad areas were explored within the survey and within each, a number of key issues:

1. Trustees' attitudes towards social responsibility and its relation to investment practice:
   - The influence of social and environmental issues on the market capitalisation of quoted companies in both the short and longer term.
   - Standards of corporate disclosure on social and environmental impacts and risks.
   - The impact of engagement.

2. How these issues impact on the investment practice of pension funds:
   - The mechanisms and procedures to integrate social, ethical and environmental (SEE) issues into investment practice – the extent of their use both now and over the next three years.
   - The barriers to further integration and their significance.
   - The roles of pension fund members and service providers.

3. The role, if any, that the Government should play in encouraging socially responsible investment in three areas:
   - Encouraging higher standards of disclosure and a longer term perspective.
   - Promoting best practice.
   - Legislating or regulating perceived conflicts of interest within the broader fund management community.

To explore these complex issues Ashridge used a three-stage approach:
- Desktop research and a series of in-depth scoping interviews.
- A questionnaire survey of pension fund trustees.
- A series of commentaries from leading experts offering a range of perspectives on the survey results.

The research process
The starting point for the project was desktop research and a series of interviews to identify the key areas for investigation and how they might be examined best in a questionnaire survey of pension fund trustees. Ashridge and Just Pensions would like to thank the following interviewees for their support:

- Tim Currell, Watson Wyatt LLP
- Marc Fox, Goldman Sachs
- Rob Lake, Henderson Global Investors
- Tom Powdrill, Trades Union Congress (TUC)
- Nick Sykes, Mercer Investment Consulting
- Sue Ward, Pensions Resource Groups (PRG)

[4] The findings from these surveys were published in 2003 and 2004 respectively.

On the basis of the findings from this phase, Ashridge developed a questionnaire survey. It was tested in September and was in the field between October and the beginning of December 2005. Ashridge would like to thank the TUC for its support in the distribution of the questionnaire to approximately 1000 trustees. Trustees from 79 pension funds responded to the survey.
Respondents represented pension funds with the following market values:

Over £1 billion	35%[5]
Between £0.5-£1 billion	9%
Between £0.25-£0.5 billion	9%
Under £0.25 billion	47%

Respondents represented pension funds from the following sectors:

Private	72%
Public	14%
Charities and not for profit organisations	10%
Other[6]	4%

Four out of five (80%) respondents had received investment training. Within this training SEE issues accounted for less than half an hour for 67% of respondents. However, for nearly one in five (18%) it was over two hours.

Enriching the research

The research presented here demonstrates a broad range of opinion on the current state and future of SRI in the UK pension fund industry. In an attempt to further explore some of this complexity, Just Pensions secured a range of expert commentators to write short articles in response to the survey results. Ashridge and Just Pensions would like to thank the following commentators for their support:

- Brendan Barber, Trades Union Congress (TUC)
- Cllr Howard Bluston, London Borough of Harrow
- Sumi Dhanarajan and Helena Vines Fiestas, Oxfam GB
- Christine Farnish, National Association of Pension Funds (NAPF)
- Emma Hunt, Mercer Investment Consulting
- Howard Pearce, Environment Agency

[5] Many of the funds in this category vastly exceeded £1 billion – e.g. 4% were over £10 billion and a further 3% between £5-10 billion.
[6] These were multi-sector funds.

3.2. The significance of social, ethical and environmental issues

Trustees were asked to what extent six areas of corporate behaviour would impact on the value of the FTSE100 in both the short and longer terms. The FTSE100 was taken as a proxy for large companies in general. For the purpose of this research, the six issues listed below constitute responsible corporate behaviour and so the basis of SRI[7]:

- Effective environmental impact
- Good employment practices
- Respect for local needs in the developing world
- Good corporate governance
- Communication and transparency on social and environmental practices
- Quality of customer relations

Short term significance

As may be seen from Table 1, within the next year, few of the SEE issues raised with trustees are expected to have a major positive impact on market value. Only two issues were seen as having a substantial impact by more than one in ten respondents – good corporate governance (25%) and quality of customer relations (26%). Thus in terms of short term impacts trustees' attitudes have not changed significantly since the 2003 survey.

For five of the six dimensions over half of the respondents thought they would have at least some positive impact within the next year. Only 37% believed that respect for local needs would have at least some positive impact within the next year. Remarkably few respondents thought that the issues would have any negative impact on market value.

TABLE 1:
In your opinion, how much does each of the following impact on the market value of the FTSE100 in the short term (1 year)?

	Substantial positive impact	Some positive impact	No impact	Some negative impact	Substantial negative impact	Don't Know
Effective environmental management	3%	55%	36%	5%	0%	1%
Good employment practices	8%	61%	27%	3%	0%	1%
Respect for local needs in the developing world	3%	34%	57%	5%	0%	1%
Good corporate governance	25%	59%	15%	0%	0%	1%
Communication and transparency on social and environmental practices	5%	46%	43%	3%	0%	3%
Quality of customer relations	26%	49%	24%	0%	0%	1%

[7] This is in part to enable comparison with the findings from the two earlier surveys.

These overall findings mask considerable variations between the attitudes of trustees from funds of different sizes. Trustees from the public sector believed that two issues were most likely to have a substantial impact in the short term. Good corporate governance was identified by one in five (20%) public sector trustees as having a substantial impact within the next year. The quality of customer relations was identified by more than one in four (27%).

For trustees representing charities and not for profit organisations two issues also stood out. More than one in ten thought that two issues would have a substantial impact in the short term – good corporate governance (13%) and good employment practice (13%). In contrast at least some private sector trustees thought that all of the six dimensions would have a substantial impact. However, for only two issues did more than 10% of private sector trustees believe that the impact would be substantial in the short term – good corporate governance (26%) and quality of customer relations (30%).

Attitudes of trustees from different sized funds appeared to vary less. Attitudes to the impact of customer relations showed the greatest differences between trustees from the largest[8] and smallest[9] funds. Nearly nine out of ten trustees from the largest funds thought that the quality of customer relations would have at least some positive impact which included 44% who thought it would have a substantial impact. In contrast, while eight in ten trustees from the smallest funds thought that the quality of customer relations would have at least some positive impact, only 31% thought that it would have a substantial positive impact.

Comparing the results from the 2005 survey against the initial 2002 survey reveals both similarities and differences. In both surveys good corporate governance and the quality of customer relations were identified most frequently as the issues likely to have a substantial impact in the short term. However, while good corporate governance was identified by 38% of respondents as having a substantial impact in the short term by respondents in 2002, this figure has dropped to 25% in 2005. In contrast 26% of respondents in both surveys believed that the quality of customer relations would have a substantial impact in the short term.

Looking to the longer term

Respondents were also asked about the impact of performance in these dimensions over the next five to ten years – and a very different picture emerged. Over three-quarters of respondents thought that all six areas of responsible corporate behaviour would have at least some positive impact (see table 2). In comparison to the 2003 survey the most significant change of attitude is in relation to respect for local needs in the developing world. In 2003 just over half of respondents believed that it would have at least some positive impact – in 2005 this figure has risen to over three quarters (76%).

TABLE 2:
In your opinion, how much will each of the following impact on the market value of the FTSE100 in the longer term (5-10 years)?

	Substantial positive impact	Some positive impact	No impact	Some negative impact	Substantial negative impact	Don’t Know
Effective environmental management	34%	55%	10%	0%	0%	1%
Good employment practices	26%	54%	19%	0%	0%	1%
Respect for local needs in the developing world	15%	61%	22%	1%	0%	1%
Good corporate governance	43%	43%	11%	0%	0%	3%
Communication and transparency on social and environmental practices	28%	52%	19%	0%	0%	1%
Quality of customer relations	43%	42%	15%	0%	0%	0%

[8] Funds with a market value in excess of £1 billion.
[9] Funds with a market value less than £250 million.

Comparing the responses from the 2003 and 2005 surveys reveals some interesting trends (see table 3). More trustees believed that all six dimensions would have a substantial impact in the longer term. In 2003 corporate governance stood out as the area most thought would have a substantial impact. In 2005 the other dimensions have all narrowed the lead and quality of customer relations achieved level pegging with corporate governance.

TABLE 3:
Proportion of respondents who believe that the following will have a substantial positive impact on the market value of the FTSE100 in the longer term (5-10 years)

	2003 Survery	2005 Survery	Change
Effective environmental management	26%	34%	+8%
Good employment practices	20%	26%	+6%
Respect for local needs in the developing world	9%	15%	+6%
Good corporate governance	42%	43%	+1%
Communication and transparency on social and environmental practices	23%	28%	+5%
Quality of customer relations	38%	43%	+5%

The overall results again hide considerable differences in the attitudes of trustees. Comparing funds of different sizes revealed that by far the biggest difference was how they viewed the impact of the quality of customer relations. Trustees from the largest funds were twice as likely to believe that it would have a substantial impact on market value – (60% versus 31%). The survey found considerable variation in the attitudes of public, private and charitable sector trustees (see table 4). Interestingly, with the exception of the quality of customer relations, trustees from private sector pension funds were much less likely to see any of the areas as having a longer term impact.

TABLE 4:
Proportion of respondents in 2005 who believe that the following will have a substantial positive impact on the market value of the FTSE 100 in the longer term (5-10 years)

	Private sector	Public sector	Charitable sector
Effective environmental management	29%	36%	63%
Good employment practices	22%	27%	50%
Respect for local needs in the developing world	11%	18%	25%
Good corporate governance	37%	64%	63%
Communication and transparency on social and environmental practices	23%	36%	50%
Quality of customer relations	43%	55%	38%

The quality of company reporting

Investors need reliable information to assess the environmental and social performance of companies. As table 5 shows, few trustees believe that companies provide sufficient information to enable effective decision-making. Compared with 2003, fewer trustees believe that companies are providing sufficient information – then 16% of trustees thought companies were providing sufficient environmental information and 13% thought they were providing sufficient social information.

TABLE 5:
Do you believe that companies are providing sufficient information to enable impacts and risks to be assessed effectively?

	Yes	No	Don't Know
In terms of environmental impacts and risks	11%	77%	12%
In terms of social impacts and risks	8%	74%	18%

Trustees with investment training were more likely to believe that companies were providing sufficient environmental information (12% said yes compared to 7% who had not undergone investment training) and social information (9% versus 7%). Trustees from funds for the charitable sector were more likely than others to believe that companies were providing sufficient environmental and social information (13% for both). Trustees from the largest funds were also more likely to be positive about environmental (13%) but not about social (8%) information enabling effective assessment.

The impact of engagement

The two earlier studies by Ashridge found widespread recognition among pension fund trustees of the relevance of responsible business practice to financial performance. As can be seen from table 6, trustees continue to believe that pension fund activism, particularly in the longer term, will have a powerful influence on the way companies manage environmental and social impacts and risks.

TABLE 6
To what extent will pension fund activism lead to improvements in the way companies manage environmental and social impacts and risks (within each of the following time scales)?

	Substantial improvement	Some improvement	No improvement	Don't know
Within one year	1%	27%	65%	7%
Within three years	5%	69%	20%	6%
Within ten years	45%	45%	4%	6%

The 2003 survey produced results that were remarkably consistent with these results. As with the 2003 survey[10], respondents from the largest funds were more positive about the impact of engagement than trustees from the smallest funds. For example, while 48% of trustees from the largest funds thought that it would lead to substantial improvements within ten years, only 32% from the smallest funds thought that it would do so. Trustees from the public sector were much more bullish about the impacts of shareholder activism than private sector trustees (60% versus 40%). Those with investment training were also more bullish than those who had not undertaken training.

[10] Just Pensions (2003) Will UK Pension Funds Become More Responsible?: www.justpensions.org.

3.3. INVESTMENT PRACTICE

Current and Future Integration of SEE Issues

Interviewees for this research expressed concern about the extent to which pension funds were implementing commitments made in their Statements of Investment Principles (SIPs)[11]. As with the 2003 survey only 13% of respondents to the questionnaire reported that their SIPs state that social, ethical and environmental concerns are not taken into account. However, for those who wish to see pension funds integrating social, ethical and environmental issues into their investment practice the results presented in table 7 do represent a very real advance over the results from the 2003 survey.

TABLE 7:
To what extent are the following mechanisms currently used by your pension fund in dealing with social, ethical and environmental issues?

	Not used	Used a little	Used a lot	Don't know
Positive screening (i.e. selecting best performing companies in which to invest or favouring specific sectors)	42%	25%	15%	18%
Negative screening (i.e. excluding certain sectors or companies)	51%	18%	11%	20%
Engaging with investee companies to encourage better performance	25%	25%	40%	10%
Exercising voting rights	16%	38%	38%	8%

Much greater use is being made of two mechanisms in particular. The use of negative screening appears to have increased considerably. In 2003, only 2% of respondents said their fund was using it a lot compared with 11% in 2005 – a fivefold increase. Engaging with investee companies to encourage better performance also appears to have increased considerably. In 2003 only 26% of respondents reported that their fund was using it a lot compared with 40% in 2005.

The results in table 7 also conceal considerable variation in the mechanisms used by the largest and smallest funds. Table 8 outlines the percentage of the largest and smallest funds that report using each mechanism a lot.

TABLE 8:
To what extent are the following mechanisms currently used a lot by your pension fund in dealing with social, ethical and environmental issues?

	Largest funds	Smallest funds
Positive screening (i.e. selecting best performing companies in which to invest or favouring specific sectors)	16%	17%
Negative screening (i.e. excluding certain sectors or companies)	4%	17%
Engaging with investee companies to encourage better performance	58%	25%
Exercising voting rights	50%	28%

[11] HMSO (1999) The Occupational Pension Schemes Amendment Regulations 1999: Statutory Instrument 1999 No. 1849: www.legislation.hmso.gov.uk/si/si1999/19991849.htm.

Interestingly there was also considerable variation between pension funds from the public, private and charitable sectors. Particularly interesting is the extent to which the pension funds from charities and not for profits are making use of all of the mechanisms. Table 9 outlines the proportion from each sector that report using each mechanism a lot.

TABLE 9:
To what extent are the following mechanisms currently used a lot by your pension fund in dealing with social, ethical and environmental issues?

	Private	Public	Charitable
Positive screening (i.e. selecting best performing companies in which to invest or favouring specific sectors)	13%	11%	38%
Negative screening (i.e. excluding certain sectors or companies)	7%	11%	38%
Engaging with investee companies to encourage better performance	38%	20%	63%
Exercising voting rights	35%	20%	75%

Ashridge then went on to explore how investment practice would change over the next three years (see table 10).

TABLE 10:
Over the next three years to what extent will your pension fund use these mechanisms to deal with SEE issues?

	Use a lot more	Use a little more	No change	Use a little less	Use a lot less	Don't know
Positive screening (i.e. selecting best performing companies in which to invest or favouring specific sectors)	7%	22%	48%	0%	0%	23%
Negative screening (i.e. excluding certain sectors or companies)	7%	15%	56%	0%	0%	22%
Engaging with investee companies to encourage better performance	11%	34%	46%	0%	0%	9%
Exercising voting rights	15%	33%	40%	1%	0%	11%

While the use of screening will increase, the biggest changes among UK pension funds over the next three years will be the substantial increases in both engagement with investee companies and in exercising voting rights. It seems that trustees favour the various forms of engagement over screening as a way to implement SRI. This finding is strongly in accord with the findings from the 2003 survey.

This research suggests that larger funds will continue to drive engagement but that smaller funds will become much more active. For example, among the smallest funds 14% reported that they would be making a lot more use of engagement with investee companies and 20% said they would be exercising their voting rights a lot more. In contrast among the largest funds only 8% said they would be making a lot more use of engagement and 12% said they would be exercising their voting rights a lot more.

It was among the private sector pension funds that the highest levels of exercising voting rights a lot more could be found (17% compared with 13% among charities and 10% among public sector funds).

Barriers to integration

During the course of the scoping interviews prior to distribution of the questionnaire, a range of potential barriers to the integration of SEE issues into investment practice were identified. Table 11 shows that trustees believe that there are currently many significant barriers to be overcome if SEE issues are to be taken into greater account in investment practice.

Most of these can be seen as clustering around two contentious issues – cost versus benefit and the quality of current evaluation tools. Thus in terms of the barriers to further integration of SEE issues there is little change since the 2003 survey.

However, when these results are taken in the context of the importance trustees attach to SEE issues over the longer term, the changes in pension fund investment practice and how they view the likely impact of pension fund activism, it is clear that these barriers are not seen as insurmountable – particularly in the longer term.

TABLE 11

How significant a barrier does each of the following represent to your fund in taking social, ethical and environmental issues into greater account in investment practice?

	No significance	Some significance	Great significance	Don't know	N/A
Uncertainty as to the financial benefits	13%	49%	29%	6%	3%
Concerns about additional costs	14%	52%	27%	4%	3%
Concerns raised in legal or investment advice	16%	46%	26%	11%	1%
Lack of tools to evaluate financial impact on investee companies	12%	44%	19%	19%	6%
Lack of tools to evaluate the competence of fund managers	21%	39%	23%	13%	4%
Lack of tools to evaluate the competence of advisers (e.g. investment consultants, legal advisers)	22%	43%	17%	14%	4%
Conflicts of interest within the fund management industry	24%	33%	13%	24%	6%
These issues are currently not seen as a priority	20%	29%	24%	14%	13%

For the largest funds the most commonly cited barrier of great significance was uncertainty as to the financial benefits. Trustees from four in ten of the largest funds identified this uncertainty as of great significance. In contrast less than one in five (19%) of trustees from the smallest funds saw uncertainty as to the financial benefits as being a barrier of great significance. For the smallest funds concerns raised by legal or investment advice was the barrier most commonly cited as having great significance (28%).

Trustees from different types of organisation saw the barriers to greater integration within their own funds very differently. Broadly speaking private sector pension fund trustees' views on which barriers are significant are in line with the overall findings. The barrier most frequently cited as having great significance was uncertainty as to the financial benefits. At least four in ten trustees from public sector funds identified three barriers as having a great significance – uncertainty as to the financial benefits, concerns about the additional costs, and concerns raised in legal or investment advice. These findings reveal a dramatic change in attitudes among public sector trustees. In 2004 only two of the barriers were identified as of great significance by more than one in five public sector trustees – lack of tools to evaluate the competence of fund managers (21%) and these issues are currently not seen as a priority (26%).

Among pension fund trustees from charities the most commonly cited barrier of high significance is concerns raised by legal or investment advice – cited by 38% of respondents. The next barrier most commonly cited as having great significance was that these issues are currently not seen as a priority – cited by 20% of respondents.

Who informs investment strategy?

Overall, it seems that the strategies adopted by UK pension funds for addressing SEE issues are influenced most by the advice provided by investment consultants (see table 12). This finding is consistent with the findings from both the 2002 and 2003 surveys. Legal advisers and the approach to corporate social responsibility taken by the organisation to which the pension fund is attached are also both important factors. However, their relative importance has changed since 2003. The proportion of respondents who place great significance on legal advice has declined somewhat (from 33% to 28%) while the proportion placing great significance on the approach their organisation is taking towards responsible organisational behaviour has increased slightly (from 25% to 27%).

TABLE 12
When deciding on the appropriate strategy for dealing with social, ethical and environmental issues for your fund, how significant was each of the following?

	No significance	Some significance	Great significance	Don't know	N/A
The views of members	53%	21%	13%	7%	6%
Advice from investment consultants	9%	43%	39%	5%	4%
Advice from legal advisers	19%	39%	28%	9%	5%
The approach your organisation takes to responsible organisational behaviour	19%	42%	27%	8%	4%

Perhaps unsurprisingly given that many pension funds find great difficulty in engaging with their membership, the views of members are reported as the least influential when deciding strategy. Once again this finding is consistent with the earlier surveys. For example, in 2002 only 12% of respondents had consulted members to decide on the appropriate strategy for dealing with SEE issues. The extent to which private sector pension funds place significance on the views of members was broadly in line with the overall findings. However a very different picture emerges in relation to public and charitable sector pension funds. Half of charitable sector pension funds place great significance on the views of members. In stark contrast, no public sector respondent said that the views of members had great significance.

Working with advisors and service providers

As can be seen in table 13, the use of formal procedures in many areas is still relatively limited. However, compared to the findings from the 2003 survey, some positive developments can be discerned. Firstly the proportion of respondents who reported that their fund has formal procedures to incorporate SEE issues in the appointment of investment consultants has increased considerably (from 16% in 2003 to 24% in 2005). The use of formal procedures to incorporate SEE issues in the appointment of fund managers has also increased slightly (from 28% to 30%). What has not changed is the proportion of funds that have formal procedures to incorporate SEE issues into the ongoing assessment of fund managers.

TABLE 13:
Which of the following does your fund use to include social, ethical and environmental issues in investment practice?

	Yes	No	Don't know	N/A
Formal procedures to incorporate SEE issues in the appointment of investment consultants	24%	51%	18%	7%
Formal procedures to incorporate SEE issues in the appointment of fund managers	30%	49%	14%	7%
The inclusion of SEE issues in Investment Management Agreements	30%	43%	17%	10%
Formal procedures to incorporate SEE issues into the on-going assessment of fund managers	25%	51%	16%	8%

Variations between funds of different sizes in the 2005 survey appear to be relatively minor. In contrast, larger funds in 2003 were slightly more likely to employ the formal procedures identified in table 13 than smaller ones. The largest variations in the use of formal mechanisms can be seen in their contrasting use by public and charitable sector pension funds (see table 14).

TABLE 14:
Which of the following does your fund use to include social, ethical and environmental issues in investment practice?

	Charitable sector	Public sector
Formal procedures to incorporate SEE issues in the appointment of investment consultants	50%	10%
Formal procedures to incorporate SEE issues in the appointment of fund managers	75%	0%
The inclusion of SEE issues in Investment Management Agreements	50%	0%
Formal procedures to incorporate SEE issues into the on-going assessment of fund managers	63%	0%

TABLE 15:
To what extent did the social, ethical and environmental expertise impact on your selection of the following service providers?

	Substantial impact	Some impact	No impact	Don't know	N/A
Investment consultants	5%	19%	61%	5%	10%
Legal advisors	7%	12%	69%	7%	5%
Fund managers	8%	24%	54%	7%	7%

Given the concerns respondents felt about the lack of tools to evaluate service providers, it is not surprising that few trustees expressed high confidence in their ability to assess their expertise (see table 16). It also goes some way towards explaining the relative lack of impact SEE issues have in the selection of service providers (see table 15).

TABLE 16:
How confident are you in your fund's ability to assess the expertise of the following service providers on social, ethical and environmental grounds?

	No confidence	Some confidence	High confidence	Don't know	N/A
Investment consultants	22%	49%	16%	11%	2%
Legal advisors	24%	42%	18%	15%	1%
Fund managers	19%	47%	19%	12%	3%

Trustees from the largest funds had slightly higher levels of confidence in their ability to assess the expertise of service providers on SEE issues. In sharp contrast, no public sector trustee expressed high confidence in their funds ability to assess the expertise of any service provider on SEE grounds.

3.4. THE ROLE OF GOVERNMENT

Through legislation and regulation the UK Government could play a role in overcoming many of the barriers to the wider adoption of SRI. This section explores trustees' attitudes as to the appropriate role of Government in encouraging greater integration of social, ethical and environmental issues into investment decisions.

Higher standards of disclosure

Interviewees for this research, and indeed the earlier studies, identified higher standards of disclosure and the greater transparency it brings as a powerful driver for change. Overall, there was a clear majority in favour of a public policy mechanism to require UK pension funds to report on the implementation of their SIPs[12].

TABLE 17:
To what extent do you agree that additional regulation or legislation is needed to require pension funds to report on the implementation of their SIPs in their report and accounts?

Strongly disagree	Disagree	Neutral	Agree	Strongly agree	Don't know
0%	9%	24%	33%	33%	1%

When this question was posed in 2003 the responses were much less supportive. For example 20% of respondents either disagreed or strongly disagreed while only 21% strongly agreed.

Defined contribution schemes

For several years now many of those interested in SRI have placed faith in the role of defined contribution schemes in growing the market for SRI. Ashridge explored this possibility by suggesting that the Government might require all such schemes to at least offer an "ethical" option (see table 18).

TABLE 18:
To what extent do you agree that it should be a legal requirement for defined contribution schemes in the UK to offer an "ethical" option?

Strongly disagree	Disagree	Neutral	Agree	Strongly agree	Don't know
3%	8%	22%	40%	23%	4%

Support for an "ethical" option has increased since 2003. In 2003 only 51% agreed or strongly agreed compared with 63% in 2005. In 2005 levels of agreement by funds of different sizes were similar. However, support among trustees from public and charitable sector pension funds was much higher than among private sector fund trustees. Having considered this question, those surveyed were then asked how such a measure might work in practice (see Table 19).

[12] HMSO (1999) The Occupational Pension Schemes Amendment Regulations 1999: Statutory Instrument 1999 No. 1849: www.legislation.hmso.gov.uk/si/si1999/19991849.htm.

TABLE 19:
If such an ethical option did become a legal requirement, which of the following mechanisms for dealing with social, ethical and environmental issues would be appropriate?

	Yes	No	Don't know
Positive screening (i.e. selecting best performing companies in which to invest or favouring specific sectors)	70%	17%	13%
Negative screening (i.e. excluding certain sectors or companies)	51%	39%	10%
Engaging with investee companies to encourage better performance	83%	7%	10%
Exercising voting rights	86%	4%	10%

Noteworthy is the high levels of support for all of the mechanisms, with only negative screening receiving less support. This represents a considerable increase in support compared to the findings from 2003 (see table 20). Particularly interesting is the increased levels of support for positive screening.

TABLE 20:
If such an ethical option did become a legal requirement, which of the following mechanisms for dealing with social, ethical and environmental issues would be appropriate?

	2003	2005	Change in support
Positive screening (i.e. selecting best performing companies in which to invest or favouring specific sectors)	52%	70%	+18%
Negative screening (i.e. excluding certain sectors or companies)	45%	51%	+6%
Engaging with investee companies to encourage better performance	75%	83%	+8%
Exercising voting rights	79%	86%	+7%

Promoting best practice

There was clear support for a code of best practice for pension funds in dealing with SEE issues (see table 21). Overall, such a voluntary approach attracted slightly more support than the legislative and regulatory options described above.

TABLE 21:
To what extent do you agree that the UK Government should promote a formal code of best practice for pension funds in dealing with social, ethical and environmental issues?

Strongly disagree	Disagree	Neutral	Agree	Strongly agree	Don't know
0%	8%	22%	42%	27%	1%

As in the 2003 attitudes were divided. The most supportive were trustees from charitable sector pension funds (75% agreed strongly) followed by public sector funds (36% agreed strongly), and the least supportive were trustees from private sector pension funds (only 18% agreed strongly). Attitudes of trustees from differently sized funds appear to be similar.

Encouraging a longer term perspective

Many commentators on SRI have suggested that the strength of the business case for its wider adoption is dependent largely on investment time horizons. That is, many believe that the benefits of responsible corporate behaviour do not tend to manifest in the short term, but do make themselves felt over the longer term. The argument therefore is that SEE issues become more relevant to financial return if longer investment time horizons are adopted (for whatever reason) and naturally this would encourage the greater incorporation of SEE issues into investment practice. It has been suggested that the Government should act to provoke such a change, at least in part to promote SRI, but also to encourage more active ownership in general.

Trustees were asked about the role of Government in encouraging a longer term perspective within the investment community as a whole rather than in just pension funds. A clear majority (64%) agreed that Government should use its legislative and regulatory powers to encourage investors to commit for the longer term in equity investment. However a significant number of trustees (36%) either disagree or are neutral on this as an important question (see table 22). These results are very much in line with the findings from the 2003 survey.

TABLE 22:
To what extent do you agree that there is a need for legislation or regulation by the UK Government to encourage a longer term perspective in equity investment?

Strongly disagree	Disagree	Neutral	Agree	Strongly agree	Don't know
4%	8%	22%	40%	26%	0%

However, those who would support such a public policy initiative seemed to favour higher dividends and tax breaks as the most appropriate mechanisms (see table 23). Larger funds were broadly in line with the overall results in relation to voting rights (46%) and higher dividends for long term shareholders (76%). However, they were slightly more circumspect about lower capital gains (65%) than other trustees.

TABLE 23:
If you expressed agreement that the UK Government should encourage a longer term perspective, which of the following mechanisms (if any) would you favour?

	Yes	No	Don't Know
Higher dividends for long term shareholders (say, of 5 years or more)	74%	18%	8%
Greater voting rights for long term shareholders	48%	33%	19%
Lower capital gains tax when long term shareholders sell shares	76%	14%	10%

Conflicts of interest

Conflicts of interest within the finance sector have attracted considerable attention from regulators and the media for quite some time. As could be seen in table 11, conflicts of interest are seen as a significant barrier to the growth of SRI by many trustees. There is also a significant body of opinion that it is important enough for the Government to do something about it. Well over half of respondents would like to see legislation or regulation to address perceived conflicts of interest in the fund management industry (see table 24).

TABLE 24:
To what extent do you agree that additional legislation or regulation is required to address perceived conflicts of interest within the fund management industry?

Strongly disagree	Disagree	Neutral	Agree	Strongly agree	Don't know
1%	8%	34%	36%	18%	3%

While 50% of private sector trustees either agreed or strongly agreed that additional legislation or regulation is required to address perceived conflicts of interest with the fund management industry, the figures were much higher among those from the public sector (72%) and charitable sector (63%).

4. LOOKING FORWARD

With the publication of this report, the Just Pensions programme will come to an end. Both trustees and industry commentators have welcomed its achievements over its five year life. As well as informing and assisting trustees and developing resources, Just Pensions has provided a focal point for interchange and partnership between pension funds, asset managers, civil society and Government and has helped generate the ideas and motivation for other collaborative projects.

We believe key Just Pensions publications will continue to provide valuable assistance to pension fund trustees in the coming years. These include the Just Pensions Responsible Investment Trustee Toolkit[13] and the set of eleven sector notes[14], compiled with asset managers, to help trustees understand potentially material social, ethical and environmental risks in key FTSE industry sectors.

As this report shows, there is still much to do to enable and encourage pension funds to take full account of environmental, social and governance issues and to contribute to and benefit from sustainable development. There is increasing recognition that new approaches are needed both to meet pension fund liabilities and to counter major threats to wealth creation and economic wellbeing such as climate change and global insecurity.

UKSIF will continue to support this important agenda. Moving forward, our key priorities will be to assist:

- public sector pension funds to respond to the UK Government's commitment to be a leader in sustainable public procurement within the EU by 2009. Significant steps are now being taken towards more sustainable procurement of investment services by the French Reserve Fund and others in continental Europe. The challenge is to ensure that UK public sector pension funds do not lag behind.
- major corporate pension funds to respond to opportunities for leadership in sustainable and responsible investment and benefit from the corporate social responsibility and sustainability expertise within their plan sponsors.
- all pension fund trustees to develop their knowledge and understanding of sustainable and responsible investment.
- Government to provide a supportive framework for pension funds to undertake long term responsible investment.

We will be starting a new Sustainable Pensions programme from April 2006. This will use and build on the knowledge and resources developed during Just Pensions. It will help corporate and public sector pension funds to respond to the challenges of sustainable development and the low carbon economy by using their supply chain pressure to encourage more environmentally responsible corporate behaviour.

This report demonstrates the increasing recognition that investments which support high quality of life, environmental protection and sustainable livelihoods worldwide are in the best long term interests of pension funds beneficiaries. But, too often, this recognition is still not translated into practice. We look forward to co-operating with others in the UK and internationally to build on the achievements of Just Pensions and so respond to this important challenge.

Penny Shepherd
Chief Executive
UK Social Investment Forum

[13] Just Pensions (2005) Responsible Investment Trustee Toolkit: www.justpensions.org.
[14] Just Pensions (2003-2005) Sector Notes Series: www.justpensions.org.

5. COMMENTARIES

Brendan Barber, General Secretary, Trades Union Congress (TUC)

Once again the Just Pensions survey of pension fund trustees' views has provided some encouraging results for those of us looking to develop a long term responsible investment culture in the UK. The work Just Pensions has done across the three surveys of trustees' views has been invaluable both in talking to a group of decision-makers who have often tended to be overlooked, and in tracking how views about responsible investment are evolving.

Perhaps the most striking message from this latest survey is the fact that, when it comes to long term performance of investee companies, trustees increasingly put a similar value on the importance of issues of corporate social responsibility as those of corporate governance.

Not so long ago even governance was dismissed by many investors as an irrelevance, but in the past few years taking account of issues such as board structure and executive remuneration has become a mainstream activity. In contrast, at present questions of social responsibility are taken seriously by some key investors, but hardly considered by many others. On the strength of this survey it would appear that trustees are beginning to take more notice. This should give us some hope that in the longer term the rather false divide between governance and social responsibility will begin to dissolve.

Of course it is not all good news. It is noticeable that trustees of private sector pension schemes are significantly more sceptical about the importance of extra-financial issues than their equivalents in the public and voluntary sectors. Strangely, of all the factors, the issue on which there is the biggest divergence of opinions is corporate governance.

Such differences should be of some concern. Whilst there is bound to be some divergence, either extra-financial issues matter or they do not. They cannot contribute to investee company performance for one group of investors but not another. What the survey seems to confirm is that there are cultural differences between trustees from different sectors. It maybe easier, for example, for trustees of a trade union or charity staff pension fund to instigate a discussion about responsible investment, than those in a private sector scheme. Advocates of responsible investment must make it a priority to try and redress this balance. After all the large majority of pension fund assets belong to private sector pension schemes.

Looking ahead, it is interesting to see an emerging consensus amongst trustees that further Government support for long term investment strategies would be helpful. Overall two thirds of respondents backed legislation or regulation in this area. Although there will need to be much thought about exactly what measures could help trustees, and the realistic chances of them being implemented, the strong support for further initiatives should at least help move the debate on.

The Just Pensions surveys have provided unique research. When the first survey was published[15], studies of the opinions of trustees, as opposed to other decision-makers in pensions, were rare. Now they are increasingly common. In addition, carrying and publishing the research has made many trustees think seriously about responsible investment. In that sense Just Pensions has made an important contribution to getting such ideas onto the pension fund agenda.

Let's hope that in the future those of us that have been involved in the Just Pensions project can have a similar impact on the actual decisions trustees make.

Cllr Howard Bluston, Chair - Pension Fund Investments Panel, London Borough of Harrow

As someone who monitors SRI on a regular basis, I find the findings both welcome and unsurprising.

The good news is that progress has been made in virtually all areas since the last survey. Most important is that awareness of the significance of SRI has increased enormously, to the extent that the Government now appears to recognise its value. This can probably be attributed to the increased public awareness of the importance of new and effective pension legislation, as borne out during the General Election campaign.

The differing views of the various trustees - whether in public, private or charitable organisations - is interesting. However, all seem to agree that good corporate governance, and better customer relations, is much more noticeable. What does not surprise me (and UKSIF know that this

[15] Just Pensions (2003) Will UK Pension Funds Become More Responsible?: www.justpensions.org.

has been my view for some time) is that most respondents believe that all six areas covered concerning corporate behaviour will become progressively more significant in the longer term. This tide could become inexorable. The substantial increase in support for positive screening is noteworthy in this respect, but at least there are also many converts to negative screening from no action at all!

I am convinced that this reflects the fact that, in all areas of SRI, trustees are becoming more aware, more responsible and more professional. It is up to each scheme to use its advisers to good effect, as is indicated in the survey, to influence companies for the better.

What of course must be remembered is that only in the last few years has it been established that adherence to SRI views and principles does not necessarily impair investment performance. In any event, it will take much further reasoned effort (and lobbying) to convince our legislators to institute appropriate measures for effective SRI.

As this is the end of the Just Pensions programme, I would like to congratulate the Just Pensions team and others who have contributed to such a great and increasingly influential programme. I look forward to hearing about the progress of UKSIF's new Sustainable Pensions programme.

Sumi Dhanarajan and Helena Vines Fiestas, Policy Advisers - Private Sector Team, Oxfam GB

The CSR agenda is well and truly a teenager, with all the awkward, gangly, 'pimpliness', and the occasional epiphanies that come with the territory. This last year alone has seen this manifest: from progress such as Nike's publication of its full list of suppliers as to allow better monitoring of labour standards in its supply-chains, to setbacks like the abolishment of the OFR and the avenue it created to encourage reporting on SEE issues. It is a time when the balance between giving guidance and allowing for experimentation is a fine one which has to be judged and managed well. This year's survey provides a good indication of where the challenges lie.

Where there is a vibrant, thriving and responsible private sector, there are greater possibilities for sustainable development and economic growth that can alleviate poverty. These possibilities however, only materialise when companies integrate their social and environmental responsibilities into their core business operations and decision-making processes. When this happens, businesses have the potential to: create jobs that offer decent and fair working conditions; make goods and services accessible to and affordable for poor people; enable poor producers to access markets; generate revenues that contribute to basic services spend; and promote respect for human rights and protection of the environment through their operations.

The choice and act of such integration is a deliberate one though. When it is not made or taken, contributions to economic growth, wealth and job creation may not automatically translate into pro-poor development, and often, can contribute towards deepening poverty. In this context, three of the survey findings struck us particularly:

Firstly, that longer investment time horizons are necessary if companies are to be incentivised to integrate SEE issues into their core operations. This is a challenge that Oxfam has come up against in each sector that we have campaigned on: pharmaceuticals, coffee and retail. In a short term environment where analysts' pre-determine the measures of success, it is hard to convince companies that an alternative pro-poor business model can be a value creator, where all the other signals indicate otherwise.

Secondly, that there is clear ask upon Government by trustees to play a much stronger and direct role by providing the appropriate regulatory environment. One opportunity to do so is in supporting amendments to the Company Law Reform Bill to introduce a duty of care requirement into director's duties which ensures their consideration of the consequences to communities, the environment, health and safety of their employees, and shareholders before making a decision.

Thirdly, that respect for local needs in the developing world is still a low priority but is increasing in importance. As some developing countries increasingly become viable markets, and their citizens become attractive customers, it will be imperative for companies to secure their 'license to operate'. This necessarily means paying greater attention to local needs. Further, the increasing presence of emerging market (EME) companies in the portfolios of pension funds as well as

FTSE100 companies in EMEs, makes it extremely relevant for local needs to be addressed in order to contribute towards a stable, prosperous business environment.

Oxfam continues to be encouraged by the steady support from and uptake of the SRI agenda by pension funds. We believe that this provides one of the better routes towards ensuring socially and environmentally responsible behaviour by companies that will contribute to the fight against poverty.

Christine Farnish, Chief Executive, National Association of Pension Funds (NAPF)

The Just Pensions (2005/6) 'Will UK Pension Funds Become More Responsible? A Survey of Trustees' report is, once again, a welcome contribution to the on-going debate about pension fund investment. This last year has seen increased focus on the need for sound and prudent pension fund investment, in the wake of further closures of pensions schemes to new members, and in view of the continuing growth in significant funding deficits. It has also seen a growing emphasis on the role of trustees in ensuring sound scheme funding and pension fund investment, under the new Pensions Act, and on the need for trustee knowledge and understanding.

In addition to these big picture issues, the Myners agenda is still alive and kicking with the NAPF's own 2005 survey[16] showing a steady upward trend in compliance with the Myners Principles. This was recognised by the Treasury in their recent review of progress[17] on this front. Ensuring that institutional investors take their ownership responsibilities seriously in respect to equity investment is, of course, a key part of the Myners agenda and we are pleased to see the positive progress in this area. The Institutional Shareholders Committee's Statement on Shareholder Activism[18] has been updated, and more and more pension funds and investment houses are applying activism principles to pension fund investment.

The Just Pensions survey focuses in on one aspect of the activism agenda – socially responsible investment (SRI). Again this year the survey results should be interpreted with some caution as respondees are a self-selected sample of 79 trustees out of a total sample of 1000, with the survey coordinated by the TUC. This may or may not be a representative sample of pension fund trustees; some social scientists might say it is likely to be biased towards those with a particular interest in the subject. Whether or not that is the case, the survey provides a useful indicator of developments on the SRI front and of trends over time.

The survey covers six issues under the SRI banner which may be confusing for some institutional investors. For example, 'good corporate governance' is one of the six. Yet some, including the NAPF, would argue that good corporate governance is somewhat different from what is generally regarded as SRI, and already an accepted part of institutional investment and standards of corporate behaviour through the Combined Code.

Some of the other issues are clearly important to good business practice and commercial success in any case – for example, having decent customer relations is a key driver of commercial success (and therefore investment performance) in the service sector of the economy; good employment practices will likewise be crucial to businesses dependent on their human capital; and effective environmental management will be critical to many commodity and other businesses that can potentially have major impacts on the environment. In these cases there is a happy coincidence of interest between the SRI agenda and commercial and investor interests. It is therefore not surprising that trustees are identifying these factors as important to pension fund investment returns in the longer term.

Trustees, however, must have prime regard to the interests of their members when deciding on investment strategy and shareholder activism. This must always be their yardstick when taking a view on the wide range of issues that can fall under the broad 'SRI' agenda. It is good to see that the survey identifies engagement as the best way to tackle these sorts of issues. This is exactly the direction which the Institutional Shareholders' Committee have identified as the best way forward.

Finally, I was disappointed to see the knee jerk call for more regulation appear as the best way in which to improve practice in this area. My firm belief is that there are better ways to proceed and that regulation should be an absolute last resort. Far better to work with market forces and encourage good practice through the well established voluntary channels we have in this country.

[16] NAPF (2005) Annual Survey: www.napf.co.uk.
[17] HM Treasury (2004) Myners Principles for Institutional Investment Decision-making - Review of Progress: www.hm-treasury.gov.uk.
[18] Institutional Shareholders Committee's Statement: www.napf.co.uk.

Emma Hunt, SRI Consultant, Mercer Investment Consulting

Environmental, social and corporate governance (ESG) issues are increasingly perceived as having the potential to impact on the financial performance of companies. The results of this latest survey by Just Pensions echo this view, with respondents indicating that almost all of the ESG issues that they were asked about could have 'some' or 'a substantial' impact on the value of FTSE 100 companies, particularly over the longer term. A recent study of US institutional investors had similar findings. Of the 183 pension plans, foundations, endowments and other long term savings pools surveyed, 75% believe ESG factors can be material to investment performance[19].

While investors may believe ESG issues can be material, this doesn't mean they are being managed. The Just Pensions report identifies a number of barriers to the integration of ESG issues within investment processes, such as a perceived financial cost of doing so (relative to the benefits), the quality of tools for evaluating the impact of ESG issues on performance and fund manager competencies in this area.

Encouraging trends are emerging which suggest that these barriers are being addressed. Collaborative initiatives by pension funds and fund managers on engagement activity are increasingly prevalent. The quality and quantity of sell-side research is increasing, and, with initiatives such as the Enhanced Analytics Initiative[20], we expect this trend to continue. The issue of fund manager competence is also being addressed. Within Mercer Investment Consulting, we have reviewed and rated a large number of managers in relation to how they vote and engage on ESG issues, as well as the extent to which an analysis of these factors is integrated into their traditional investment decision making[21].

These developments are beginning to provide tools for pension trustees to overcome the barriers discussed above. Trustees also benefit from an increasing body of intellectual capital that has amassed over recent years within the field of responsible investment. We expect this combination of tools and knowledge to result in an increased focus on ESG considerations by UK investors over time. While we expect a focus on ESG issues by UK pension trustees to grow, we cannot ignore the fact that there are many other pressing issues facing funds today. Pension scheme deficits in FTSE 350 companies have risen by almost a quarter in 2005 despite strong equity performance[22]. Relative to such concerns, ESG issues may struggle to reach the top of the agenda.

But this need not be an insurmountable barrier. ESG issues are already part of each pension scheme's Statement of Investment Principles (SIP)[23] and therefore a valid part of the regular review of investment policy. As trustees consider their position on ESG issues in the light of industry developments, policy is likely to be strengthened, communicated to service providers and a monitoring mechanism put in place to ensure that this part of the investment policy is being carried out. Findings of a recent survey of 157 investment managers from around the world[24] suggest that a significant proportion of managers expect a rise in client demand for integrating consideration of ESG issues into investment decision making over the next three years. More notably, almost half the UK investment managers expect clients will want specialist investment strategies based on ESG analysis.

Fund managers and others in the investment chain have a good track record of responding to evolving client needs. They are already gearing up to respond to continued signals from UK pension trustees that appropriate consideration of ESG issues is important. To ensure this continues, trustees should allocate some time to consider their ESG positions, develop policies, and communicate these to managers. After all, they are the top of the investment food chain.

[19] Mercer (2006) Perspectives on Responsible Investment: www.mercerIC.com.
[20] Enhanced Analytics Initiative (EAI): www.enhanced-analytics.com.
[21] Mercer: For results of initial manager ratings: www.mercerIC.com/ESGresearch.
[22] Mercer (2006) FTSE 350 – Pension Scheme Deficits and Trends: www.mercerIC.com.
[23] SRI Pensions Disclosure Regulation (2000) requiring pension schemes to disclose the extent to which they take into account social, environmental and ethical issues in their investment policies.
[24] Mercer (2006) Fearless Forecast: www.mercerIC.com. Full ESG results launched in February 2006.

Howard Pearce, Head of Environmental Finance and Pension Fund Management, Environment Agency

It is fair to say 2005 was marked by some globally significant environmental events such as the Boxing Day Tsunami, Hurricane Katrina, the New Orleans floods, the Pakistani earth-quake and other extreme natural phenomena.

In the UK there were record floods in some parts of Northern England, winter drought in parts of Southern England and the Buncefield refinery disaster which have had significant social and economic impacts.

Most scientists accept that mankind is increasingly damaging the planet's natural resilience and that the world's climate is changing quite significantly. The impact of such changes will increasingly influence where, and how we live, and all do business. This will impact on both local and global economies and thus every pension fund and pensioner.

Although it was a small sample size it is noteworthy and important that 63% of trustees consider that effective environmental management has a short term impact on the market value of companies and 89% think it has a longer term impact.

But despite this, over 50% of trustees don't feel that environmental issues influence key strategic investment decisions, or impact much on the selection of key advisors and fund managers and the overall investment process. Moreover only 11% of the trustees felt that companies disclosed sufficient environmental information for investors to assess possible risks/impacts.

This might explain the apparent rising support for activism and increased corporate engagement and voting. However it is concerning that 65% think both these tools will have no impact in a 1 year time horizon and 90% think any benefits might take 10 years. Both these seem to suggest other types of trustee responses may be required which can change corporate strategy and behaviour more rapidly.

To fulfill their fiduciary duty to protect the interests of current and future beneficiaries of pension funds - increasingly trustees will need to encourage and select asset managers who take greater account of environmental risks (like climate change) in their investment processes such as sector/stock selection and weightings than hitherto.

Some pension funds, investment consultants, and assets managers are now responding positively to this challenge (and opportunity) which is to be applauded and welcomed. However new and more leaders need to emerge from both the public and private sector to ensure the sustainability of pension funds and that pensioners can continue to enjoy their retirement in a clean and safe environment.

In this respect I applaud Just Pensions for its work in this area and look forward to seeing how UKSIF's new Sustainable Pensions programme develops.

JUSTPENSIONS

SOCIALLY RESPONSIBLE INVESTMENT AND INTERNATIONAL DEVELOPMENT

The Just Pensions programme was initiated by Traidcraft and War on Want, and subsequently managed by the UK Social Investment Forum (UKSIF)

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