



UK Social Investment Forum (UKSIF) 2005 Annual Lecture

Thursday 14 April 2005

Respondent's Speech

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Introductory remarks

Thank you for that introduction. I am honoured to have been invited to respond to, and offer some comments, on Christine's presentation which was most interesting.

I was fascinated to hear her background was in ecology and conservation. This is also my professional background – and it seems quite a lot of other people in the pensions world.

Maybe this is because there is a natural progression and compatibility between

- spending ones early career studying and working to conserve a healthy environment for current and future generations - and then
- wanting to invest in pension funds wisely to conserve their financial health to enable existing and future pensioners to enjoy the environment in their retirement.

However I suspect the main reasons why I am here tonight is because

- The EA Pension Fund is part of the LGPS and a member of the NAPF, UKSIF, IIGCC and CDP,
- The Agency does a lot of work to promote the links between good corporate environmental governance and good financial performance,
- The work we have done on our Pension Fund to develop and implement a financially and environmentally responsible investment strategy across our eight investment mandates.

Welcoming remarks

Firstly, let me say I really welcome the fact the NAPF has developed a draft SRI policy and that they plan to publish it – this will help raise the profile of SRI within the industry.

I also welcome the NAPF's existing high level principles on corporate governance for pension funds which recognises that

*Good standards of corporate governance are in the interests of companies themselves - as they enable them to **manage their risks** and make better strategic decisions in the interests of their **long-term** success, and in the interests of their shareholders, who are more likely to see sound long-term returns on their investments if good practice is consistently applied.*

Avoiding risk and long-term considerations are very compatible with sustainable development and SRI.

I particularly welcome her statements that:

- 1. All Company Boards should develop their own CSR policies which they should disclose to investors.*
- 2. SRI should be seen as an integral part of the normal investment management process.*
- 3. Trustees should ensure that their fund managers take into account long-term CSR and environmental issues.*
- 4. Trustees should find out how their investment managers do their research in these areas, and particularly in analysing long-term risks and opportunities for companies.*
- 5. Trustees should meet face-to-face with investment managers and make CSR issues part of the agenda of these meetings.*
- 6. Trustees should know in which companies they invest in, and have significant CSR agendas themselves.*
- 7. Trustees should consider the choice of investment funds available, understand the needs and wishes of members, and seek to offer the option of an ethical fund where there is a demand for it.*

I also note that the NAPF welcomes and supports:

- 8. Market initiatives like the Marathon Club, which is developing innovative approaches to long-term pension fund investment; and the Enhanced Analytics Initiative, which is encouraging ways to incorporate non-financial issues into sell-side research and analysis where it is felt these could have an impact on long-term investment performance.*
- 9. The introduction of OFR disclosures which will highlight CSR issues across more listed companies.*

Challenging remarks

However my role is to raise a few issues for discussion in order that these might be considered further by the NAPF. I will cover 3 things.

Firstly - CSR is an internal discipline for companies and part of the investment decision process, but it is a mistake for institutional investors to treat social, environmental and ethical considerations on a par with corporate governance analysis.

It is our view, and I believe many other LGPS funds, and progressive institutional investors, that assessing CSR is integral part of assessing the quality of a companies overall corporate governance and the prospects for a company's future success. It is important to do this and they are not separate issues.

Some companies may have good CSR reputations but may still face very significant social and environmental issues. So how these key risks are managed should be integral to its corporate governance arrangements as they can impact on financial performance – both up or down – and so are of interest to investors.

This has been backed up by an extensive review last year by “Innovest” which showed a positive correlation between corporate environmental governance and financial performance.

Secondly - SRI should be integral to the normal investment process only to the extent that it encompasses matters which the Board needs to address to be a successful business and comply with the law.

It is our view that it is entirely consistent with trustees fiduciary duties that a pension funds investment strategy should require all their managers to take account of all considerations (economic, social, environmental) that determine a company's financial performance - and - the sustainability of that performance.

Let's look at some key environmental issues. There is abundant evidence that the depletion of natural resources, damage to sensitive habitats, and the consumption of non-renewable energy supplies by business is leading to climate change and impacts on society.

These impacts are already impacting on many companies' success and future prospects, and will have an increasingly profound impact on the financial performance and sustainability of many listed companies either directly or indirectly in coming years.

We think companies need to know the impact of their externalities that fall on the environment and society as a whole. Also these costs impact on pension funds as universal investors who invest across the full spectrum of business. Pension funds need to know that companies are aware of, and are seeking to reduce these externalities as they affect long-term success.

So we consider if an environmental issue is putting a pension funds capital at risk - it is a trustees fiduciary duty to act prudently and in the beneficiaries financial interest to adopt and implement investment and corporate governance strategies to minimise that risk to protect their capital from that risk.

Indeed one could argue it would be irresponsible not to do so and trustees could be taken to court for not fulfilling their fiduciary duty.

Thirdly, while welcoming the Marathon Club and EAI – it would be good if the NAPF's SRI policy might welcome and support other pension fund and investor initiatives like UKSIF, IIGCC, and CDP.

Summary and Way Forward

So let me summarise, I welcome and support most of what Christine said and hope that the final policy might incorporate some of tonight's discussion and the views of NAPF members present here tonight. Thank you for listening.