Investor Responsibility Briefing

Insight INVESTMENT

HBOS plc

New minister for pensions reform signals review of progress on responsible investment

Stephen Timms, Minister for Pensions Reform, recently met a small group of representatives from the investment industry – including Insight's Craig Mackenize – as part of a review he is beginning of the Government's agenda on pension fund investment and social, ethical and environmental (SEE) issues. As a Minister in the Department for Work and Pensions (DWP) in 1999, Timms was instrumental in introducing new SRI and voting disclosure regulations for pension funds. Since 2000, all UK occupational pension funds have been required to reveal in their statements of investment principles, how, if at all, they take account of SEE issues and to state their voting policy. The Minister is now planning to review whether this measure has achieved the Government's intended objectives and to consider what more the Government might do to encourage progress.

The consensus at the meeting was that considerable progress has been made since 1999, catalysed, in part, by government regulation. The number of institutional asset owners in the pensions and charitable foundation sector that take account of governance and SEE issues has risen substantially, and the number of asset managers and stock brokers who conduct active research and engagement on these issues has grown significantly too. Furthermore, the methods employed to consider these issues have progressed markedly. Investors have demonstrated that, in taking account of these issues, they can help to drive significant improvements in corporate behaviour, as well as demonstrate the financial relevance of these issues to investment decision-making.

However, various concerns were also expressed at the meeting. While institutional investors in the public and charitable sector were praised for taking a proactive role in developing this agenda, corporate pension funds were criticised for failing to make as much progress. Concern was also expressed about the findings of a July 2004 DWP study that showed that, while many pension funds have altered their statement of principles to include a commitment to take account of governance and SEE issues, few appear to have taken significant actions to implement their commitments. For example, the research showed that only 23% of the pension funds surveyed had considered the issue of shareholder activism and just 15% had taken a formal, minuted decision to act as a result of this consideration. Of those, 75% decided to rely on the shareholder activism policies of their existing fund managers, rather than develop agendas of their own.

Another more fundamental concern was also raised. Many question whether prevailing investment practices generate the kind of sustainable, responsible and productive business activity that the government would like to see. Concerns were expressed over short-term mandates (i.e. that last for only three years) and the widespread use of relative financial performance against index benchmarks to evaluate fund managers. Many believe that these do not incentivise fund managers to give sufficient weight to long-term value creation or to the place of governance and SEE factors in securing it. It was noted that company directors frequently express frustration that pressure from the City to meet quarterly earnings forecasts obstructs their efforts to invest in the kind of tangible and intangible assets necessary to achieve long-term growth. The picture is complicated by the fact that some companies do seem to manage these issues better than others. However, there was consensus that fostering a long-term investment culture was a priority, both because it is believed to be important to value creation and because it is supportive of a more sustainable and responsible approach to business success.

The Minister concluded by saying: "I see this as the start of a dialogue and the beginning of what I hope will be an important contribution to the debate on pensions, and in due course to the long-term settlement that we are seeking." He expressed the view that there is much to be done to promote a responsible and sustainable long-term investment culture, and has asked for further details and proposals based on the points raised at the meeting for his further consideration.

Insight believes that investors have a very important role in contributing to more sustainable, responsible and productive corporate practice, both through active ownership and better investment analysis. To do this effectively, we need the support and enthusiasm of our clients in the pension industry and elsewhere. As Stephen Timms' disclosure regulation in 2000 has shown, carefully targeted government intervention can help to focus attention on these issues and catalyse useful debate. Insight welcomes the chance to be involved in the Government's review of its work in this area.

October 2005

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03318-10-05