A major evolution in UK pension funds on ESG as trustees draw a Red Line

Governance policy instructions for fund managers – backed by government – could be in the market by September.

by **Hugh Wheelan** | March 11th, 2015

A perennial question on responsible investment has been the following: many larger, well-resourced pension schemes are doing it with a number of different motivations (investment agency, member pressure, public-facing role), but what about mid-and smaller-sized schemes? The beginnings of an answer are formulating in the UK.

Few people in the RI world may have had dealings with the Association of Member Nominated Trustees (AMNT), but it is a potent, not-for-profit organisation of 400+ trustees working at the heart of the boards of UK pension schemes worth £350bn pounds ($528bn); many of which are mid- and small-sized plans. By law, UK occupational pension schemes must have at least one-third member-nominated trustees. The AMNT is regularly involved in government policy discussion and development on pensions.

As RI reported earlier this week, the AMNT is launching a comply-or-explain set of “red lines” for their fund managers on environmental social and governance (ESG) voting at companies. In the relatively conservative world of UK pensions, that’s a serious evolution.

It is also, I believe, a sign that important, slow-burner papers such as the Kay Review and the UK government’s (notably Business Secretary Vince Cable) Stewardship push, are generating light and heat.

More importantly, the Red Line initiative broaches one of the key structural barriers of the pensions market to the take up of ESG issues: what happens to investors in pooled funds? How can investor governance rights be divisible in the pool? In the UK alone, the Investment Association, the trade group for UK fund managers, cites a figure of £5 trillion of assets managed by UK funds houses, of which half is in pooled arrangements.

At an event organised for Ownership Day (March 10) by the UK Sustainable Investment & Finance

Association (UKSIF), Janice Turner, Co-Chair of the AMNT, said one of the starting questions for the two-year Red Line project, had been “why should trustees bother” with ESG issues. She noted the growing body of evidence that corporate governance issues could be both socially and finally destructive, citing the Bhopal disaster, which still threatens serious fine and business risks for Dow Chemical 30 years after an estimated 22,000 people were killed at the Union Carbide plant in India, a business which Dow bought (an appeal hearing takes place on March 14, and this year’s AGM looks like being fractious as some shareholders argue Dow is being frozen out of business in the Indian market
because of the outstanding legal affairs.) Turner, who is also a member of the Department for Work and Pensions Trustees Panel and the Actuarial Users’ Committee of the Financial Reporting Council, said UK pension schemes with assets between £100m and £1bn were starting to look at how they might hold their fund managers to account on governance. Those schemes with less than £100m in assets, she said, were more or less told they shouldn’t waste their time trying to do so, despite representing some £300bn in assets collectively. She said the AMNT’s Red Lines would be mutually agreed positions by AMNTs on major governance questions to which fund managers would be expected to comply with the share voting steer (if approved by the pension fund), or explain why not. She said the voting positions were based on the existing guidelines of some of the UK’s biggest pension funds: “We want the Red Lines to be practical and for fund managers to have the same instructions, as we realise there is an administrative burden here. Importantly, we feel it will increase transparency for us as trustees on how our assets are being managed on important topics. In addition, we believe it will give asset managers more influence on companies because they have the back-up of the asset owners. We know this is important for the huge amounts of assets that are run in pooled funds.”

The Red Lines have been given firm support from government via a statement from Vince Cable.

Turner said they could be broadened to more E&S issues, based, for example, on verifying company adherence to the UN Global Compact. She said the Red Lines were out for consultation to the asset management industry and that they would put forward for approval at the AMNT’s summer conference with a view to introduction in September.

Asset manager responses so far appear mixed. Some have welcomed the backing from the AMNT for their stewardship efforts, and said the pooled fund administrative issue wouldn’t be easy administratively, but could be resolved. Others argue that the Red Lines will complicate corporate governance and that owners should trust their managers to get on and vote and engage with investee companies without interference. Either way, The Red Lines are a welcome call from trustees across the fund spectrum that they are thinking increasingly about how to communicate what they want on governance and E&S issues to their agents.