

Red Line Voting

What is Red Line voting and why should I help my pension scheme sign up?

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Association of Member
Nominated Trustees

Q1. What is Red Line voting?

The Red Line Voting Initiative was developed by the AMNT as our response to the call, following the financial crisis and the Kay Review, for pension schemes to take a more active asset ownership role – to become more responsible investors. By becoming more active in improving the environmental, social and corporate governance (ESG) of businesses, pension schemes would not only improve the way companies are run. Research shows that better run companies outperform their peers and therefore help pension schemes improve the longer term performance of the companies they invest in.

The initiative has been developed over more than two years with advice from member companies of the UK Sustainable Investment and Finance Association, in consultation with AMNT members, major pension schemes, fund managers, proxy voting companies, the United Nations Principles for Responsible Investment and others, and with some technical support from the Department for Business Innovation & Skills.

For more information about the AMNT, please visit www.amnt.org.

Q2. How does Red Line Voting work?

When a pension scheme or other asset owner adopts Red Line Voting it gives an instruction to fund managers to vote at company AGMs in accordance with the Red Lines, in order to promote best practice in relation to ESG matters. At the same time it makes it easier for the fund managers as they may receive Red Line Voting instructions from many clients, but they will be the same instructions. The fund managers in receipt of Red Line Voting instructions would be expected to incorporate the Red Lines into their engagement activities (i.e. discussions on environment, social and corporate governance matters) with the companies in which they are investing on the client's behalf.

Q3. What exactly are the Red Lines?

The Red Lines are a set of tightly drawn voting instructions covering a wide range of environmental, social and governance issues. We developed the governance Red Lines after studying the voting and engagement policies of our members' largest pension schemes, finding a consensus among them, and basing our Red Lines on the consensus. These are designed to implement the Financial Reporting Council's UK Corporate Governance Code (www.frc.org.uk/Our-Work/Publications/Corporate-Governance/UK-Corporate-Governance-Code-2014.pdf).

The environmental Red Lines are in furtherance of the UN Global Compact and were formulated with substantial advice from CDP (the Carbon Disclosure Project).

The social Red Lines are in furtherance of the UN Global Compact and the Financial Reporting Council's UK Corporate Governance Code.

The corporate governance Red Lines are based to a substantial degree on the consensus found among some of the largest pension schemes, which in turn are in furtherance of the UK Corporate Governance Code.

Q4. Why has the AMNT developed Red Line Voting?

The four main reasons are:

- » The majority of pension schemes are in practice unable to set an agenda for their fund managers' engagement with the companies they invest in, nor do they direct how their votes are cast at company meetings. Some have been told they are too small to get involved in this. The AMNT wants to enable all pension schemes, no matter how small, to be able to direct how the votes associated with their investments are cast, and hold their fund managers to account more effectively for their activities on the pension scheme's behalf.
- » Most small and medium sized pension schemes invest in pooled funds and may have been told that this prevents them from exercising any control over the engagement and voting of the fund managers. Some fund managers have been reluctant to allow investors to direct how the votes associated with their investments are cast, saying that if they received conflicting instructions from multiple investors it would be difficult to manage. Red Line Voting has been developed specifically to overcome these difficulties.
- » There is a lot of work involved in developing appropriate engagement and voting instructions for fund managers. The Red Line voting instructions developed by the AMNT over two years have been drafted after consultation with many others to ensure they meet best practice guidance and are workable.
- » Pension schemes that have a responsible investment policy and invest with several fund managers will have realised that different fund managers have different in-house policies on ESG issues and on voting: while most will normally vote in support of a company position on a matter, others may abstain and still others may vote against. Red Line Voting will enable more consistent implementation of the pension scheme's policy across all the fund managers it has employed.

Q5. How will my scheme sponsor(s) react to the adoption of Red Line Voting?

The Red Line Voting initiative has the objective of improving the ESG performance of your scheme's investments and is intended to have positive impact on financial performance. As stated earlier, there is an increasing body of research that shows that companies who rate well against ESG factors outperform others. It is therefore logical for sponsors to support the initiative as this should reduce their costs in the medium to long term.

Q6. Should we need to take professional advice on the adoption of the Red Lines?

Yes. Trustee boards should discuss the Red Lines with their advisers before making a decision as to whether implementing the Red Lines is right for their scheme. The AMNT is not authorised to provide investment advice and neither the Red Lines nor this document constitute investment advice.

Q7. Can I expect Red Line Voting to be supported by my scheme advisors?

Yes.

- » Your scheme investment advisor should be supportive as more and more research is indicating that the best governed companies are more successful.
- » Your scheme actuary will be less directly affected by the initiative but should be supportive as adoption of Red Line Voting should reduce the risks associated with investments.
- » Your scheme lawyer should be supportive as the Law Commission have concluded that there is no impediment to trustees taking account of environmental, social or governance factors where they are, or may be, financially material. There is also increasing guidance requiring pension schemes to be active in the area of responsible investment, including the UK Stewardship Code and the Law Commission's report on fiduciary duties.
- » If you visit: We support the Red Line Voting initiative> you will see a list of organisations, including the statement from the Government Department of Business Innovation & Skills, in support of this initiative.

Q8. Is Red Line Voting the same as ethical investment?

No. Ethical investing is designed to show moral disapproval of or support for activities unrelated to financial risks or returns. Most frequently ethical investing employs negative or positive screening to exclude or include investments in particular companies or sectors solely on the basis of that ethical belief. Red Line Voting does not screen in or out any stocks and does not adopt an ethical view on any given investment. It has been designed to apply to all UK-based equity investments regardless of how stocks are selected.

Red Line Voting is all about good stewardship of the companies that your pension scheme already invests in, by setting out the environmental, social and corporate governance policies and activities you expect of them. This is called Responsible Investment.

Q9. Why is responsible investment important?

First, it is extremely important to ensure that the companies you invest in are well run because failures of governance can lead to pension schemes losing money in both the short and long term. For example, companies that are exposed as being involved in dubious practices or not treating their employees well have suffered reputational damage, consumer boycotts and/or industrial action; others that have broken the law or regulations have been ordered to pay vast fines. These include financial irregularities, health and safety breaches that have caused terrible loss of life or accidents that have caused large-scale environmental damage.

The Law Commission's 2014 report titled *The Fiduciary Duties of Investment Intermediaries* states: "It is clearly in the interests of pension funds as a whole to do all they can to promote the long term success of the companies in which they invest. We think that trustees should be encouraged to consider whether and how to engage with companies to promote their long term success, either directly or through their investment managers."

They go on to state: "While it is clear that trustees may take into account environmental, social and governance factors in making investment decisions where they are, or maybe, financially material, we believe the law goes further: trustees should take into account financial material factors."

You may also have read that, in addition to increasing demands from pension scheme members that their scheme take greater account of ESG matters, there are emerging suggestions that legal action may be taken against pension scheme boards that do not take the risks of climate change into account with the companies they invest in. So pension scheme boards need a way to respond to this growing concern.

Q10. Are the Red Lines to be applied globally?

No. They are being developed solely for use with companies listed on the London Stock Exchange. There have been many suggestions that it should be extended to other markets so we anticipate their extension to foreign equities and fixed income over time.

Q11. Do I have to sign up to all the Red Lines?

Pension schemes can choose to adopt all or some Red Lines. Those who adopt the Red Lines will instruct their fund managers to comply with them. The fund managers are at liberty to vote contrary to a Red Line if in their judgement it is more appropriate in an individual case to do so, but if they do they are required to explain why they did.

Q12. If my scheme adopts the Red Lines will this involve the trustees in more work?

Some work is involved in deciding, with your advisors, whether implementing the Red Lines is right for your scheme. The AMNT has tried to keep this work to a minimum by working with as many parties as practicable in the development of the instructions.

Professional advisers to pension schemes adopting the Red Lines may advise that it is necessary to amend the Statement of Investment Principles accordingly. (The law requires the Statement of Investment Principles to set out “the extent (if at all) to which social, environmental or ethical considerations are taken into account in the selection, retention and realisation of investments”.)

Your fund managers should be required to report regularly on how they have implemented the Red Lines. This could be half-yearly or as frequently as they normally report on the engagement and voting that they currently carry out on your scheme’s behalf.

Q13. Will adopting the Red Lines cost my scheme?

Since December 2010 all UK-authorized asset managers are required under the Financial Conduct Authority’s Conduct of Business Rules to produce a statement of commitment to the UK Stewardship Code or explain why it is not appropriate to their business model and, if it does not commit to the Code, its alternative investment strategy.

Therefore the asset owner will already be paying for the asset manager’s engagement and voting activities with regard to the funds in which the pension scheme invests. The AMNT does not expect pension schemes to pay any additional fees. In the event of attempts to levy further charges the AMNT asks to be informed of this. Red Line voting recommendations are to be available in the market from one or more of the proxy voting agencies which should make the assessment easier for asset managers.

Q14. We already vote the investments that we hold in segregated funds but cannot vote in pooled funds. What can we do?

The trustee board may wish to consider whether to adopt Red Line Voting just for its pooled funds. It may also wish to consider whether its current policy covers environmental and social matters as well as corporate governance.

Q15. What is the contractual situation with our fund managers?

Your professional advisers will confirm this. Our research suggests that some small schemes’ contracts with fund managers are silent on the matter of engagement and voting. Others may state that it is delegated. Still others may be different. However a fund manager that wishes to respond to its client’s stated requirements should be happy to comply with new arrangements, and be pleased at the increased concern about environmental, social and corporate governance issues among their clients.

Q16. What do I do if my fund managers won’t comply?

We don’t think this is likely to happen. But if they won’t you can take this into account along with all other factors when deciding what to do with your investments. And if a fund manager refused to comply, the AMNT asks to be informed of this.

Q17. If I want to know more about Red Line Voting who do I contact?

If your scheme investment advisors are publicly supporting Red Line Voting see www.redlinevoting.org/red-line-friendly-companies/ they will be able to help. If not, please contact info@redlinevoting.org.

Q18. Why sign up to Red Line Voting?

By joining with other asset owners to improve the environmental, social and corporate governance of businesses you would be raising the standards of UK listed companies and helping to increase action against climate change, which is the biggest threat to our long term investment returns. You will also hopefully be helping to make the world a fairer, safer and more sustainable place.