

Responsible Investment Trustee Best Practice Guide

What is Responsible Investment?

Responsible Investment (RI) refers to investment where environmental, social, and governance (ESG) considerations are taken into account in the selection, retention and realisation of investments and the responsible use of rights (such as voting rights) attached to investments. RI recognises that investors' financial objectives are inextricably linked with their concerns about ESG issues. RI objectives are typically achieved through engagement with companies; other approaches include screening and positive selection.



Fiduciary Duty and RI

Some trustees believe they are prevented from implementing RI policies on the basis of the *Cowan v. Scargill* case, which sought to prevent the Mineworkers' pension scheme from investing overseas or in industries competing with coal.

A recent legal opinion from Freshfields Bruckhaus Deringer (Freshfields), however, states that the *Cowan v. Scargill* judgement is "misunderstood" and "cannot be relied upon to support the single-minded pursuit of profit maximisation...Fiduciary duties evolve over time according to changes in social norms and the values of society...It is, for example, very unlikely that paying equal wages to men and women... would be regarded as breaches of fiduciary duties in the 21st century but all were so regarded not very long ago." ¹

Investment Returns and RI

There is considerable evidence that ESG issues can affect company and investment performance. According to Freshfields "It may be a breach of fiduciary duties to fail to take account of ESG considerations that are relevant and to give them appropriate weight, bearing in mind that some important economic analysts and leading financial institutions are satisfied that a strong link between good ESG performance and good financial performance exists." ²

Members and RI

It is important that any RI policy clearly reflects the values and concerns of the beneficiaries; to determine this, trustees can "survey the moral or social preferences of beneficiaries in order to arrive at an investment strategy that reflects their interests." ³ However, "There is no trust law requirement to obtain the views of all beneficiaries." ⁴

Whose Values?

A common argument against RI policies which are based on members' preferences is that beneficiaries may hold conflicting opinions on ethical questions. According to Charles Scanlan "Undoubtedly, there are differing views on some issues of social responsibility...At the same time, there is likely to be a consensus on many social and environmental matters. For instance, it would...be unusual to find many scheme members who were active supporters of environmental degradation, human rights violations or forced labour... Moreover... there are generally-recognised standards, sometimes enshrined in international conventions... these can provide a non-controversial basis for a scheme's SRI principles." ⁵

About FairPensions

FairPensions is a non-profit organisation that seeks to educate trustees and members of pension funds about responsible investment.

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Disclosure and Transparency Best Practice

RI implementation begins with disclosure and transparency on policies, investments, and engagement results.

The Myners Review of Institutional Investment: *“Trustees should publish their SIP [Statement of Investment Principles] and the results of monitoring of advisers and managers...they should send key information from these annually to members of these funds, as well as posting this on a fund website...it is good practice for funds with more than 5,000 members to have a website dedicated to the fund.”*⁶

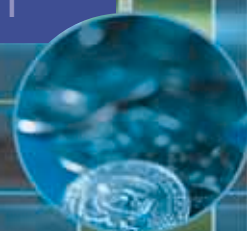
In order to demonstrate how they are implementing their RI strategy, trustees should annually disclose:

1. The SIP.
2. At least the top 100 equity investments in the scheme.
3. The annual voting record.
4. Policies on RI integration into investment mandates and fund manager monitoring and reporting requirements.
5. The specific engagement strategy (specific issues to be acted on), and the results and progress of these efforts.

Transparency should be provided through:

1. A public website with a section on RI which includes the above information.
2. A detailed RI section in the annual report, including results of key company and industry engagements, key votes and important initiatives.

INVESTMENT





Engagement Best Practice

Engagement, also known as “shareholder activism”, refers to the process by which investors seek to improve a company's performance by means of dialogue and by voting at company Annual General Meetings (AGMs). All institutional investors, including pension funds, are obliged to have clear engagement policies.

The Myners Review of Institutional Investment: *“Trustees should also ensure that managers have an explicit strategy, elucidating the circumstances in which they will intervene in a company; the approach they will use in doing so; and how they measure the effectiveness of this strategy.”*⁷

Institutional Shareholders Committee: *“Institutional shareholders and/or agents should set out the circumstances when they will actively intervene and how they propose to measure the effectiveness of doing so...[they] may want to intervene when they have concerns about...the company’s approach to corporate social responsibility (CSR).”*⁸

A best practice engagement policy includes:

1. A clear strategy for engagement, including priority issues and sectors, methods of engagement and targets.
2. Identifying and disclosing the lines of responsibility for engagement.
3. Establishing manager reporting mechanisms, trustee reviews of progress and independent assessments of engagement results.
4. Ensuring fund managers (or other agents) have experience of RI and will engage and vote according to the policy, including proposing or supporting AGM resolutions.
5. Ensuring companies adhere to standardised reporting on ESG issues and disclose whether they are in compliance with relevant industry norms, standards, or codes of conduct.
6. Requiring fund managers to actively participate in relevant collaborative RI networks.

RI Costs

*“There should be no objection in principle to the trustees incurring some expenditure on an ethical preference SRI policy, whether this be in ascertaining beneficiaries’ views or in researching or implementing the policy.”*⁹

Policy and Resourcing Best Practice

RI requires a comprehensive policy that is based on the *“best interests”* of members *“beyond merely their financial interests.”*¹⁰ It is important that policies are adequately resourced and that they are overseen by dedicated RI professionals to implement and monitor the policy execution.

Freshfields Bruckhaus Deringer: Where an ESG consideration is *“reasonably believed to be the subject of a clear consensus amongst beneficiaries”* then *“the consideration must be taken into account.”*¹¹

The Statement of Investment Principles should:

1. Incorporate members’ values (determined by polling the fund membership annually) and CSR policy.
2. Explicitly reference all asset classes.
3. State compliance with all aspects of relevant industry codes (The Myners Principles, United Nations Principles for Responsible Investment¹²); state areas of non-compliance.
4. Be reviewed on an annual basis.

The RI policy should:

1. Clearly specify areas of engagement and pension fund position on specific issues.
2. Include clear monitoring rules and process for RI implementation across all asset classes.
3. Incorporate clear guidelines on RI within all investment mandates, including empowerment on voting and/or penalties for non-compliance; ensure that a portion of fund manager performance fees are tied to RI success.
4. Ensure ethical options are available for Additional Voluntary Contributions or Defined Contribution schemes.

Resourcing should include:

1. Allocating dedicated in-house staff or advisers on RI to implement and monitor RI policy.
2. Access to external RI research to enable identification of risk areas.

REFERENCES

¹ Freshfields Bruckhaus Deringer, A legal framework for the integration of environmental, social and governance issues into institutional investment, 2005, pg 9. Download the report at: www.fairpensions.org.uk

² Ibid, pg 200

³ Ibid, pg 96

⁴ C. Scanlan (ed), Socially Responsible Investment: A Guide for Pension Schemes and Charities

⁵ Ibid, pg 98

⁶ Myners principles for institutional investment decision-making: a review of progress, 2004, revised principle 10

⁷ Ibid, revised principle 6

⁸ Institutional Shareholders Committee, “The Responsibilities of Institutional Shareholders and Agents” 2005, pg 3-4

⁹ C. Scanlan (ed), Socially Responsible Investment: A Guide for Pension Schemes and Charities, pg 101

¹⁰ Freshfields Bruckhaus Deringer, A legal framework for the integration of environmental, social and governance issues into institutional investment, 2005, pg 96

¹¹ Ibid, pg 14

¹² To download the United Nations Principles for Responsible Investment, please go to www.unpri.org