

## **Addressing the Financial Crisis – the Responsibilities of the Major Shareholders**

As the financial crisis continues to unfold, there has rightly been considerable attention paid to the role of bankers and regulators in the unravelling of the financial system. However, the role of investors – particularly the major institutional investors such as pension funds – is also central to the emerging debate on how to repair financial markets and prevent a repeat of the recent crisis.

We, a group of individuals who have long been concerned with investment issues and their impact on ordinary people and pension scheme members, believe that measures to promote responsible, long-term share ownership are an important component in creating a sustainable financial system. Today we are calling on the pensions industry and the Government to take steps to ensure that pension funds play their part in this. Such a system must promote the interests of both the companies whose shares are bought and traded and the beneficiaries with whose money investment decisions are made.

We note that recent reforms have improved the transparency and accountability of companies to their shareholders. But without incentives or requirements for investors to act on the information that is provided and ask constructive questions about the long term prospects and risks for the company, this extra transparency can be rendered meaningless. We believe this flaw in making the government's goal of "enlightened shareholder value" a reality has contributed to the current financial meltdown, the full impact of which in terms of pensions and jobs is still emerging.

We also note the existing legal obligations placed on trustees to invest predominantly in regulated markets and to invest in derivative instruments only for the purpose of minimising risk or achieving efficient portfolio management. It is clear that risks to schemes are bound up with risks to the system as a whole, and we therefore believe that there is a need for these obligations to be more clearly embedded in the principles and practice that inform investment decisions, and to include issues of systemic risk.

We believe it is now time for pension fund boards to think hard about the records of the firms they own. Recent events have shown how the failure to hold corporate leaders to account for their decisions about risk can have a catastrophic effect on the financial system, the economy, the corporations themselves and ultimately on the well-being of members of pension schemes. We also believe strongly that the same can be said of bad governance, poor labour standards and environmentally unsustainable practices. Like financial mismanagement, these factors have also been shown to have a real impact on a company's bottom line – and therefore on the returns for institutional investors such as pension funds.

As such, building an understanding of these risks into investment decision making and into engagement with firms is an essential responsibility of pension funds and the managers who

invest funds on their behalf. Boards of trustees of pension funds need to develop clear policies and guidance mandating their fund managers to engage in dialogue with companies, to vote at company AGMs and to report back on what impact their engagement has had. Alternatively, if fund managers are unable to do this, boards can delegate responsibility for this engagement to a third party.

With this in mind, we are calling for the following steps to be taken.

1. Pension funds should insert a **“do no harm” clause** into their statement of investment principles (SIP), requiring fund managers and other advisors to satisfy trustees that their investment decisions are not causing systemic harm to the stability of the financial system and therefore to the long term interests of their beneficiaries.
2. Institutional investors, particularly the large pension funds, should **sign up to the United Nations Principles of Responsible Investment (PRI)** as soon as possible. The PRI sets out a series of broad commitments for the engagement of investors with firms around corporate governance, environmental and social performance; it now has over 400 signatories, representing US\$15 trillion in assets.
3. A **collective reporting and monitoring body** should be established to ensure institutional investors are acting on commitment 1. One way to do this would be to broaden the remit of the Investment Governance Group set up as a result of the recent review of the Myners Principles.

We believe that the current crisis is of such magnitude that if satisfactory progress is not made on these points by the end of 2010, the Government should consider action to make engaged investment, specifically in line with point one, a statutory responsibility for pension funds.

At the same time, there will be a major opportunity for the Government to take a lead on this issue by developing a responsible and engaged investment strategy for the new national pensions saving scheme known as Personal Accounts which will be launched in 2012 and whose funds are likely to reach £200-300bn by 2050<sup>1</sup>.

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<sup>1</sup> Pensions Policy Institute Briefing Note 42, December 2007