From bonus clawbacks to massive lawsuits, pension funds are sharpening their teeth. The shareholder spring of 2012 heralded an awakening among institutional investors. Agrieved shareholders accused the boards of FTSE 100 companies, including Aviva, UBS and Barclays, of rewarding themselves handsomely despite lacklustre performance.

Since then, fund managers have raised their voices, most recently speaking out about management failings at Sports Direct. Meanwhile, pension funds have been encouraged by receiving backing from UK Prime Minister Theresa May, who has pledged repeatedly to address irresponsible behaviour in big business.

Pressure group ShareAction is increasingly seeing transatlantic co-operation between pension schemes, reports campaigns manager Juliet Phillips. For instance, oil giant ExxonMobil has faced repeated challenges to annually assess the impact that government climate policies, which are required to keep increases in global temperatures to below 2 degrees centigrade, would have on its assets. Much of the pressure has come from the New York State retirement fund and the Church of England.

World Pensions Forum director general and World Bank advisory board member Nicholas Firzli believes that this new era is a result of the 2007-8 financial crisis. “The widespread social disenchantment that followed the great recession had an impact on voters and governments across the northern hemisphere,” he says.

Companies are opening their doors, reports, RWC’s European Focus Fund co-head of asset manager Petteri Soininen. “Companies post-financial crisis have been in a situation where they need to do something, and that has created an opportunity to build a constructive dialogue. Given there have been challenges within companies, typically they are more willing to listen to outside shareholders.”

Today, pension funds are far more aware of the power they wield, especially when they join forces. Yet there is still some way to go before every pension fund can truly say they are holding the companies in which they invest to account – and not every company is listening.

Joining the fray
Many of the UK’s largest pension funds are already active stewards of their assets, engaging with boards and speaking up when they think it is necessary. Some schemes are even joining class action lawsuits [see box out]. Yet small or mid-sized pension funds may be tempted to dismiss activism as the preserve of schemes with bigger resources.

Whatever their size, schemes can have a voice. “They could use their rights in an AGM and raise a question,” suggests Phillips. “It is very rare for pension funds to go to an AGM. They would find it a useful experience as well, listening to the issues that are being raised. They could then bring it up with their asset manager.”

Asking a question at an AGM can have a huge impact, as Philip Meadowcroft found in 2012. Meadowcroft, the chairman of a small company (and a trustee of its pension fund) asked Aviva’s then-chief executive, Andrew Moss, a question referring to figures in the company’s own annual accounts: why it persisted in excessively rewarding its senior executives, while profits fell. His question, coruscating...
in its simplicity, made the front page of the Financial Times and the ensuing controversy prompted Moss' resignation.

If schemes want to make a difference, joining the UN Principles for Responsible Investment (UNPRI), which bills itself as “the world’s leading proponent of responsible investment”, is a great start, advises Green Century Capital Management president Leslie Samuelrich. The organisation is fantastic for networking, she says.

MSCI’s ESG research team executive director Ric Marshall recommends the International Corporate Governance Network, which holds regular conferences, arming shareholders with information, resources and fellow collaborators.

Also, the Association of Member-Nominated Trustees has made waves with its Red Line Voting initiative. Pension schemes can sign up to a set of voting instructions covering a wide range of ESG issues. The red lines serve as instructions to fund managers who are voting on that scheme’s behalf at company AGMs. The hope is that widespread scheme take up of the red lines will also make it easier for fund managers, who won’t have to vote based on lots of different instructions from various clients. Schemes do not have to sign up to every single red line.

Some asset managers have said that red line voting conflicts with their method of voting: many vote on behalf of their clients as a single, collective pool. Association of Member-Nominated Trustees co-chair David Weeks counters that some fund managers are already developing high-tech ways to split their vote to take account of different clients’ views.

He adds: “We have got some interest among fund managers in creating red line compliant funds. That will be a big turning point.”

Schemes should make their views unequivocally clear to their fund managers. “There is a pattern of asset managers voting with management where there is a clear rationale for voting against,” says Grace Hetherington, who leads ShareAction’s press and communications work. “Another thing we hear anecdotally is a vote against management can result in doors being closed to access to the company’s board. It is seen as ‘not done’.”
and providing positive feedback to companies that are already doing really well. The overall goal here is to improve returns across the board – this is about everyone’s economic well-being.”

**An active approach**

A barrier that schemes sometimes cite is the trend towards passive investing in the cost-constrained defined contribution (DC) environment.

However, schemes can invest in smarter indexes. For instance, Marshall explains that MSCI has a series of indices that weight stocks according to different criteria, from ESG to good governance. “They are passive vehicles, but they are becoming more and more active-like in terms of their management styles and ability to pick the stocks that are included in each index. It’s not black and white – it’s not passive versus index – there is a range of opportunities in both areas.”

Being passive doesn’t preclude action, argues Marshall. “You do not have to be an active investor to be an active owner. The two things are very different. You can invest in the indexes in the market and your concern is not just with individual companies, your concern is with the overall standards.

“As we invest more globally and look at emerging markets, where disclosure and the rule of law is not so strong, we may still want to be invested in that market and there may be compelling reasons to do so. We need to look at other ways to protect [members’] interests and participate in local regulatory improvements in standards. We may want to be involved in active engagements with individual companies, make adjustments in proxy voting policy and standards. All of these things are elements of ownership that have nothing to do with active or passive.”

Phillips agrees. “A lot of the passive fund managers are very proactive owners and see it as very important that their capital is being used correctly. It shouldn’t be a case of, ‘I’m a passive investor, I’m going to go back to sleep’.”

**Class actions**

The Greater Manchester Pension Fund made headlines in September 2016 when it joined a class action lawsuit against Volkswagen. The pension fund is one of 80 complainants, including BlackRock and the California State Teachers’ Retirement System, who are suing the car manufacturer for €2 billion in the wake of its emissions scandal.

Meanwhile, a group of investors, including pension funds and asset managers, are forming a 60-strong group to sue Tesco, claiming they have suffered £150 million in losses because of accounting inconsistencies at the supermarket.

To date, class actions have been far more popular in the US than in the UK. “We are very prone to litigation in this country,” says MSCI’s Portland-based Ric Marshall. Class actions are most often used when other forms of engagement have failed. “We are prepared to use legal avenues when we have to, as a last resort,” says RWC’s Petteri Soininen.

Green Century Capital Management president Leslie Samuelrich says: “I think [class actions] are one of the many tools in a toolkit that investors should look at. There are lots of other things investors can do before it gets to that stage ... But sometimes [companies] are secretive and you don’t know. Then I think it’s a good tool to have.”

Class actions can have constructive outcomes, says Marshall. “Not only have class actions become a more legitimate way of recouping losses in some of the really big cases, pension funds have begun to work to ensure that the leverage they have in these cases is exercised not just to recoup a loss but to require changes in the corporate governance of these companies going forward. We call that corporate reform, which is implemented in the settlement discussion.”