OWNERSHIP DAY

USE SHAREHOLDER RIGHTS TO IMPROVE YOUR RETURNS

Attitudes to Ownership 2014

Exploring pension fund and public opinion on ownership and stewardship issues

Produced by

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UK Sustainable Investment and Finance Association

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Attitudes to Ownership 2014

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UKSIF Foreword

This report marks the first discussion piece we have produced for Ownership Day and we hope it will be the first of many. This work goes to the heart of some key issues by looking at what pension funds think about their role in engagement and comparing that to public opinion. There are important differences which show that many funds are on the right lines but that they may need to flex their messages to meet the expectations and understanding of their members. It also highlights how some generally smaller funds are not yet able to engage fully which prompts concern. And if defined benefit (DB) schemes are finding it hard to engage the issue for defined contribution (DC) may well be more serious yet.

We have been delighted to work with NAPF on this inquiry into some of the fascinating data from their engagement survey 2013. And we are very grateful to Aviva Investors for their generous sponsorship.

Ownership Day is about helping asset owners in the widest sense boost long-term returns by being active and asking their agents to follow suit. The argument is becoming increasingly mainstream as the realisation spreads that a short-term focus ignores fundamental longer-term threats. This report suggests that beneficiaries are broadly sympathetic to active ownership which adds further to the case for schemes to adopt this approach.

For more information on Ownership Day please visit www.ownershipday.co.uk.

Simon Howard, UKSIF Chief Executive

NAPF Foreword

Pension funds understand that the assets they own can play an important role in determining the society members will inhabit in the future and thus the real value of their income in retirement. Therefore, in line with their duty to pursue members' best financial interests, pension funds recognise they have stewardship responsibilities which include engaging with companies and voting. In most cases however, day-to-day activities are delegated to asset managers.

The NAPF is a long-standing supporter of the UK Stewardship Code and are encouraged to see a growing number of asset owners signing up – there was a 30 % increase during 2013. More asset owner signatories will further influence behavioural changes that lead to better stewardship by asset managers and companies. Whilst increasing sign-up to the Code's Principles is important, it is crucial asset owners are able to identify those investment manager's committed to both the spirit and letter of the Code.

The NAPF's Stewardship Disclosure Framework was developed to enable trustees to compare and contrast different asset managers. More than a quarter of the asset manager Stewardship Code signatories have completed a Framework and these are available on the NAPF website. This extra transparency should catalyse the market for 'good' stewardship and provide an incentive for asset managers to compete in a 'race to the top'. For pension funds, being 'active owners' is not about their 'going greener' but about achieving better outcomes for members.

Will Pomroy, NAPF Policy Lead: Corporate Governance

Aviva Investors Foreword

Aviva Investors is predominantly a long-term, risk-averse investor. Our parent company – Aviva plc – can trace its history back more than three hundred years to 1696. As both insurers and investors we are well accustomed to thinking in the long term. Over the next few decades we see sustainable development as a matter of key importance to our clients, to the companies in which we invest and to global economic growth.

However, these long term sustainability issues are regularly overlooked by the capital markets because the financial pressures are to focus much more on the short term. Short-termism reduces the long term return potential for our customers and undermines the ability of capital markets to deliver sustainable economic development.

The Stewardship Code is an important commitment to the long term. It sets out a number of areas of good practice where asset owners and managers can protect the value of investments. We warmly welcome the findings outlined in this report. We support the calls for pension trustees to govern the long-term stewardship of their fund managers, holding us to account for good performance. In this way, their demand will help to ensure that capital markets integrate sustainability issues throughout the supply chain of capital, reducing risks to companies and the global economy – and help secure sustainable development.

Steve Waygood, Chief Responsible Investment Officer, Aviva Investors

Introduction

The importance of the concepts of long-termism, responsible ownership and engaged investing is increasingly apparent in policy, asset management strategies and public scrutiny of the financial services sector as a whole

The question of ensuring trust and confidence in DC is a critical challenge for the UK, linking to wider reputational issues faced by the financial services industry

Investment Management Association

Active ownership, or stewardship, commonly refers to engagement and the use of shareholder rights to improve the long-term value of a company. For all investors – from individuals with ISAs and savings to global institutional investors and pension funds – it is about understanding that the shares they hold make them part-owners of those companies, as such they should consider encouraging those who manage their money to engage on their behalf with investee companies to protect and increase value. That can involve using both AGM votes and direct engagement to support effective and well-executed business strategies, and also to challenge poor risk management, ineffective delivery or a disproportionate focus on short-term issues at the expense of long-term value.

Effective and collective shareholder intervention can be a powerful tool for ensuring the responsible and sustainable management of a company. It is in shareholders' best interest to ensure that they are actively engaged in how their capital is being managed. Since the 2008 financial crisis a focus on the importance of the concepts of long-termism and engaged investing is apparent in policy, asset management strategies and public scrutiny of the financial services sector as a whole.

This report uses data gathered by the NAPF for its 2013 Engagement Survey and a 2014 YouGov survey of the Great British public run by UKSIF[1] to examine both pension funds' and the publics' views on a range of active ownership issues. The 'Talking Points' within the report are intended to stimulate debate and discussion of these issues.

According to the Investment Management Association, the UK institutional market is estimated at £2.7 trillion, of which pension assets account for £2 trillion. NAPF fund members represent approximately £900 billion in assets under management.

The vast majority of pension fund assets relate to defined benefit pension arrangements. Figures provided by the NAPF from its' 2013 Annual Survey suggest that the percentage of UK defined benefit (DB) pension scheme assets invested in equities is now around 30% with the percentage invested in UK equities down to 8.8%. The rise of defined contribution (DC) pension schemes means however, that there is likely to be a shift back towards equities over the coming years. Given the demographics of the memberships of most DC arrangements, these schemes are commonly biased towards equities with the figures provided by the NAPF from its Annual Survey suggesting that there is an average allocation to equities of 71% in the growth phase of the average default fund.

In 2012 the process of pension auto-enrolment began meaning that over time more and more of the population will benefit from pension saving. This means that it will soon be possible to use the general public as a reasonable proxy for pension savers as we do here, and that more than ever, members of the public have a vested interest in how institutional investors, and in particular DC pension providers, are managing their assets.

Active ownership and good stewardship is all about asking the right questions. Pension funds need to ask the right questions of their consultants and their fund managers but also to consider asking questions of their members. This report explores and contrasts pension funds' and the publics' answers to some important questions on active ownership issues.

*Notes on pension fund data

The pension fund opinion data used in this report was gathered by the NAPF as part of its ninth annual survey of pension funds' engagement with investee companies. NAPF fund members with more than £1 billion in assets under management were invited to give their views. Responses were received from 48 pension funds, with combined assets under management of £394 billion.

*Notes on public opinion data

All public opinion data used in this report, unless otherwise stated are from YouGov Plc. Fieldwork was undertaken between 05–07 March 2014. Total sample size was 2,683 adults. The survey was carried out online. The figures have been weighted and are representative of all UK adults.

1 UKSIF is the UK Sustainable Finance and Investment Association, the membership association for sustainable and responsible financial services

Extra-financial factors and materiality

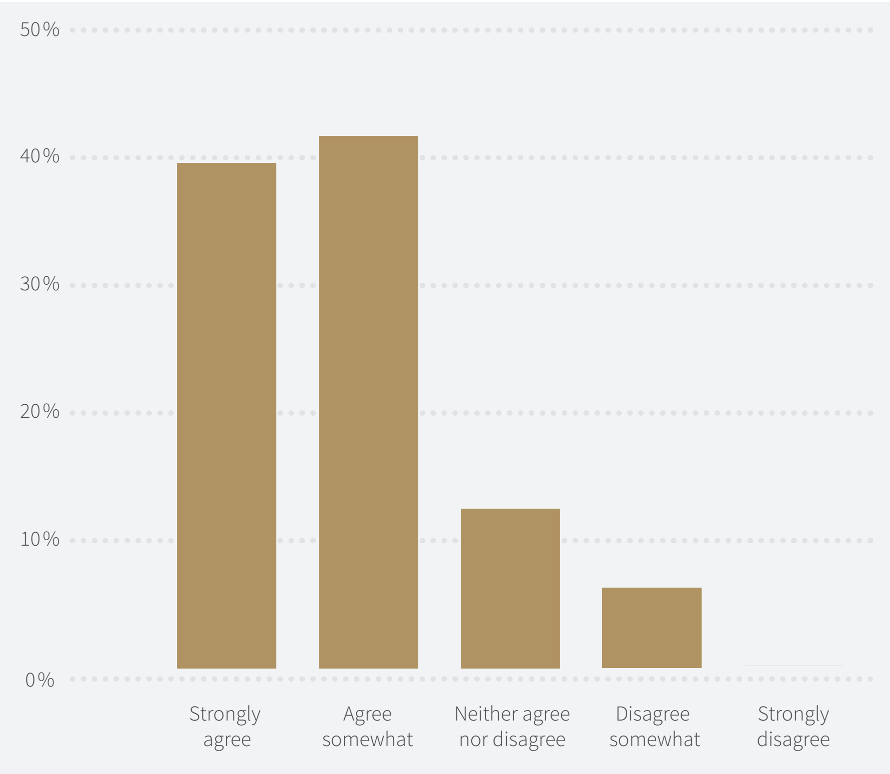
Can extra-financial factors, such as environmental, social and governance factors, have an impact on value in the long-term?

Long-term strategic issues facing companies go beyond the purely financial. There is a growing realisation that environmental, social and governance issues ("ESG") are central strategic concerns as the world faces wide-ranging threats linked to climate and the environmental limits and associated social change.

Increased emphasis on active ownership with its focus on the long-term and extra-financial factors should tend to support and encourage companies to tackle these strategic sustainability issues. This message can be conveyed by fund managers when their clients – the owners – instruct them.

Institutional investors acting in the best interest of their clients should consider the environmental and social impact of companies' activities and associated risks among a range of factors which might impact on the performance of a company, or the wider interests of savers, in the long-term

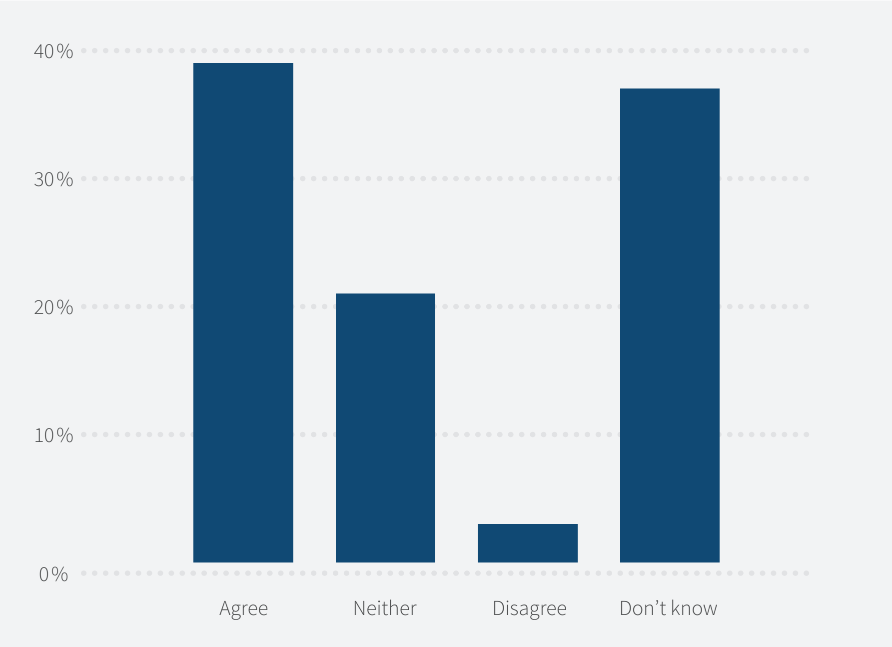
Kay Review 2012



In its October 2013 survey the NAPF asked a series of questions on these issues to pension funds. Here we examine the answers to those questions and answers from the public to a series of related questions.

Pension Fund Opinion

Question to pension funds: Do you agree that extra-financial factors eg. Environmental, social and governance factors – can have a material impact on the fund's investments in the long-term?



Public Opinion

Question to the public: To what extent do you agree or disagree with the following statement: "ESG issues and other non-financial considerations can affect the value of an investment in the long-term (i.e. increasing or decreasing its value)?".

Discussion:

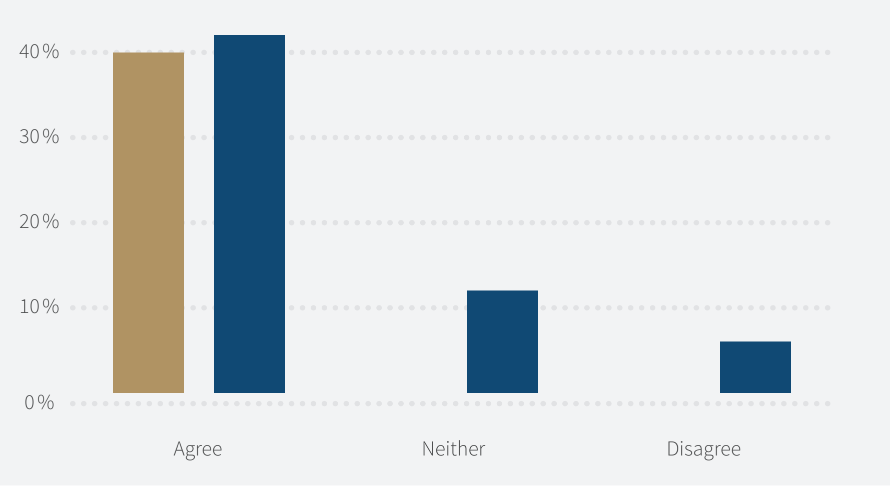
The results are interesting. In the pension universe where ESG is a more familiar concept 82% of respondents agreed that ESG factors can have a material impact on their fund's investments in the long-term. Among the public, where the term is newer, 37% said they didn't know. This may indicate the extent to which pension funds are ahead of their members, and the extent to which they need to publicise their approach. But of the public who did answer a strong majority agreed 61%. This suggests that the majority of informed pension savers probably agree with the attitude of the pension funds and should be of comfort to the funds: their members share their view. And the number of funds and members of the public that disagree are similarly broadly similar at 6% and 3% respectively.

Talking point: *Considering the high level of public respondents who felt unable to answer the question regarding ESG issues and their effect on the value of an investment in the long-term (37% 'Don't know') is there a need for pension funds to communicate with their members more effectively on this issue?*

Why do individuals not feel able to answer this question and does this indicate a lack of understanding of what can affect the value of an investment overall?

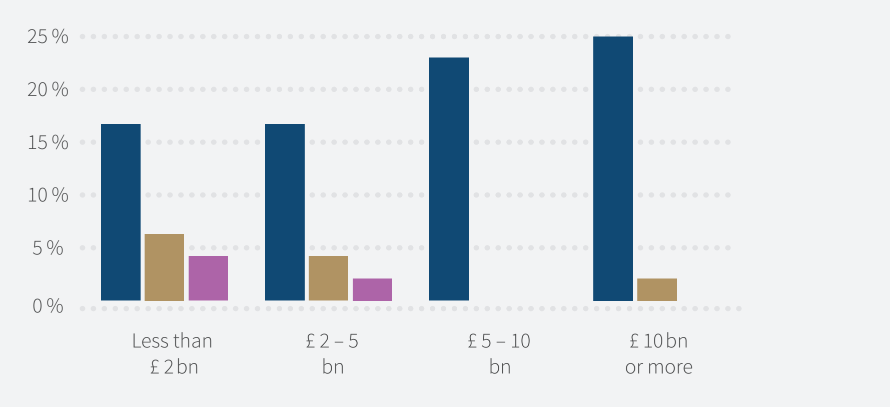
If we look in more detail at the funds that disagreed with the materiality of extra-financial factors (3), all are private sector occupational pension funds:

- Local authority & public
- Private



and those funds that disagreed are all relatively small- none has assets of over £5bn.

- Agree
- Neither
- Disagree

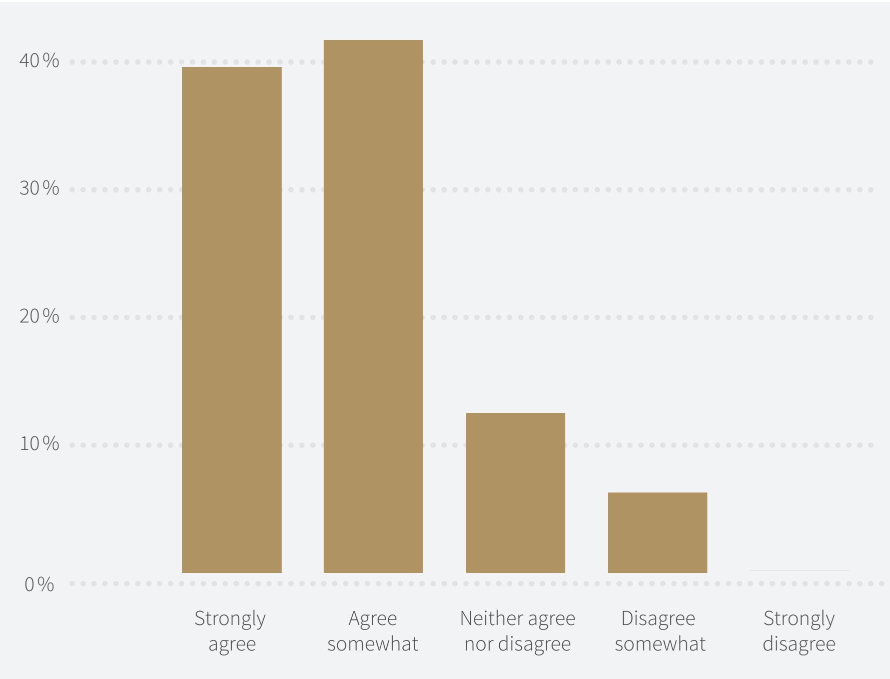


Talking point: *Although only a small number of pension funds disagreed on the materiality of ESG factors, all those that disagree are in the private sector and are relatively small in terms of AuM. There is further anecdotal evidence that smaller funds find it more difficult to fully consider ESG issues due to lack of time, resources and in some cases understanding.*

Many pension funds, particularly smaller funds, outsource investment decisions and stewardship activities. However, these funds still need to ensure they understand the potential impact of ESG factors on their fund and select investment managers and hold them accountable accordingly. Is the 'ESG burden' a problem for smaller asset owners and how can this be addressed and rectified? And what do we make of the private/public sector split?

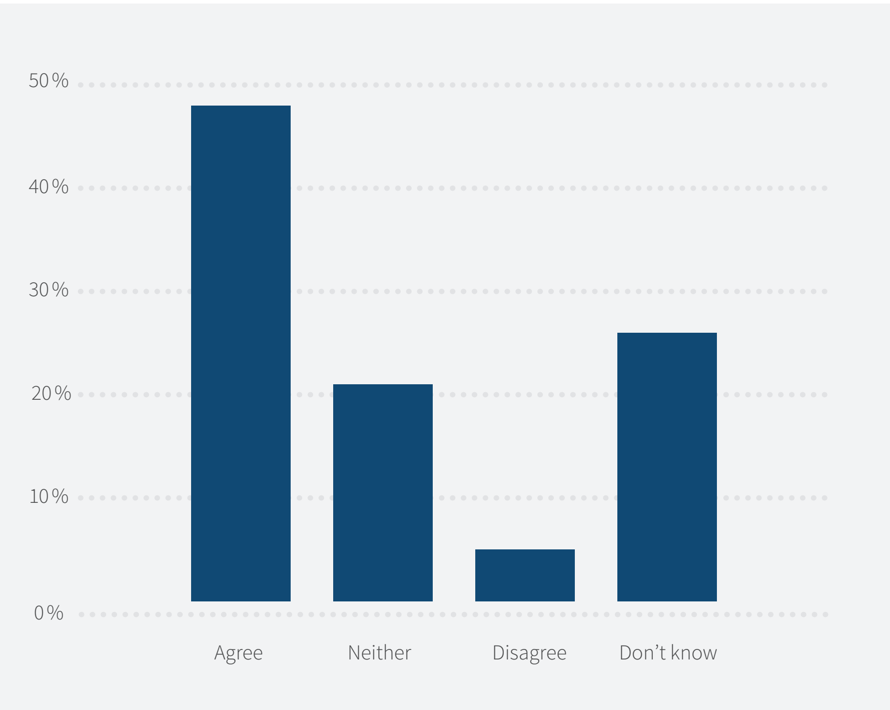
Stewardship and Responsibility

Do institutional investors have stewardship responsibilities?



Pension Fund Opinion

Question to pension funds: Do you agree that institutional investors (including pension funds) have stewardship responsibilities which include engaging with companies and voting shares?



Public Opinion

Question to public: To what extent do you agree or disagree with the following statement? “Institutional investors (such as pension funds) should have stewardship responsibilities in the companies that they invest in?”

Discussion:

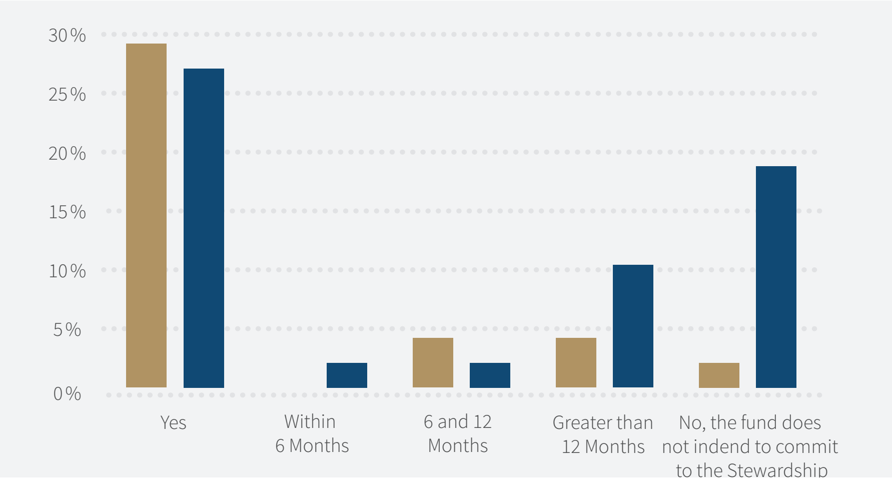
These results may also be showing how understanding among members – taking the public as a proxy for the combined DB/DC/population which is evolving- lags that of pension funds. The overwhelming majority view among those relatively large pension funds surveyed by the NAPF is that institutional investors have stewardship responsibilities. Among members of the public there is less agreement. 26 % 'don't know', which is less than those who responded 'don't know' with regards to the question on ESG.

This may reflect a greater understanding of stewardship in the sense of "doing what's right" than of ESG. This enhanced understanding suggests that "stewardship" as a concept may currently be easier to promote for funds than ESG. Again, of the members of the public who answered very few actively disagreed, thus probably validating, if validation is needed, the stance of the pension funds.

***Talking point:** With such strong agreement from pension funds and a significant level of agreement from the public it seems counterintuitive that there are only 74 asset owners currently signed up to the UK Stewardship Code. Those that are however represent a significant proportion of assets and there are positive signs of progress with a 30 % increase in signatories last year.*

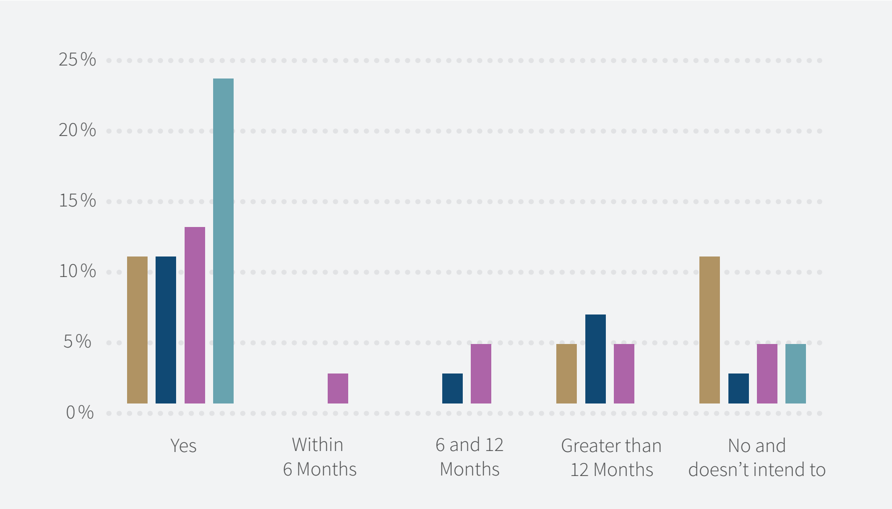
Question to pension funds: Has your fund formally committed to the Stewardship Code and its Principles?

- Local authority & public
- Private



Encouragingly most of the respondants have either already formally committed to the Stewardship Code or intend to in the future. The majority of pension funds that do not intend to are private funds. Interestlingly the majority of funds who have already committed to the Code are large funds with over £10bn in AuM.

- Less than £ 2 bn
- £ 2 – 5 bn
- £ 5 – 10 bn
- £ 10 bn or more

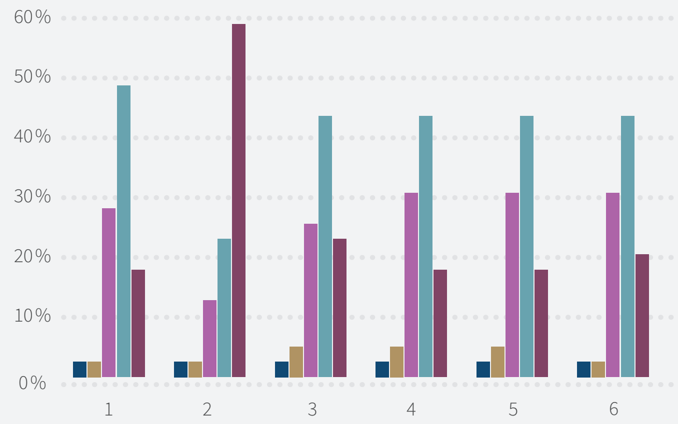


Key issues

What are some of the important environmental, social and governance issues?

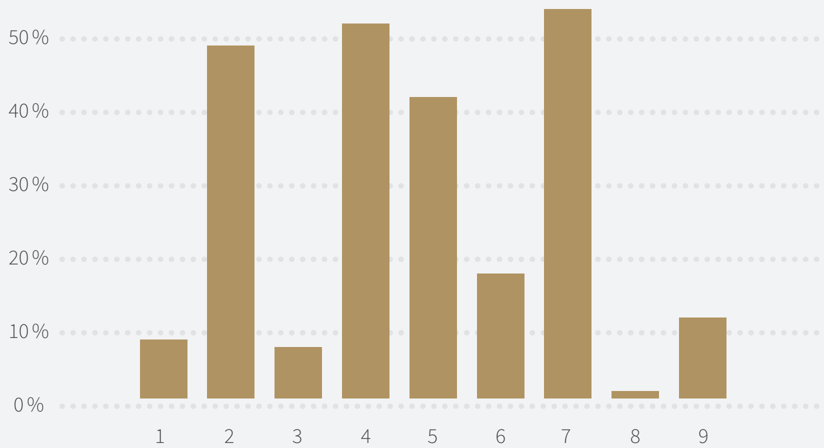
Question to pension funds: How important is it that the fund's investment managers take the following factors into consideration when making investments?

- Not important
- Slightly important
- Important
- Very important
- Extremely important



1 Board Composition (including diversity)
2 Company Strategy
3 Remuneration
4 Environmental factors
5 Social Factors (internal)
6 Social Factors (external)

Question to the public: Which of the following issues do you think are MOST important for UK pension funds to be more active about (i.e. on which issues should pension funds use their influence to try and improve how companies approach that issue)?



1 Encouraging companies to reduce their use of **fossil fuels**
2 Ensuring that **executive pay**, including bonuses, is not excessive
3 Encouraging more **women to be on the boards** of major companies
4 Encouraging all companies to pay a **'living wage'** (i.e. a wage which is high enough to maintain a normal standard of living)
5 Ensuring there are no instances of **child labour or human rights** abuses in a company's supply chain
6 Ensuring there are no instances of **animal welfare abuse** in a company's supply chain
7 Ensuring that each company pays its **fair share of UK tax**
8 Don't know
9 Not applicable – I don't think UK pension funds should be more active about any issues

In terms of key issues highlighted above it is important to note that pension fund and public opinion are not directly comparable as a)the 'issues' are not identical and b) pension funds were questioned as to their opinion of the importance of factors with regards to investment decisions as opposed to a wider social context. However it is still interesting to note the results. Although there is some alignment between pension fund and public opinion on the issue of remuneration with 93% of pension funds rating it as an important factor and a relatively high proportion (48%) of the public wanting pension funds to be more active on this issue pension funds consider remuneration to be twice as important as the public. Interestingly there seems to be a much greater discrepancy with regards to board diversity with 95% of pension funds rating this as an important factor but only 7% of the public wanting pension funds to be more active in encouraging woman on boards.

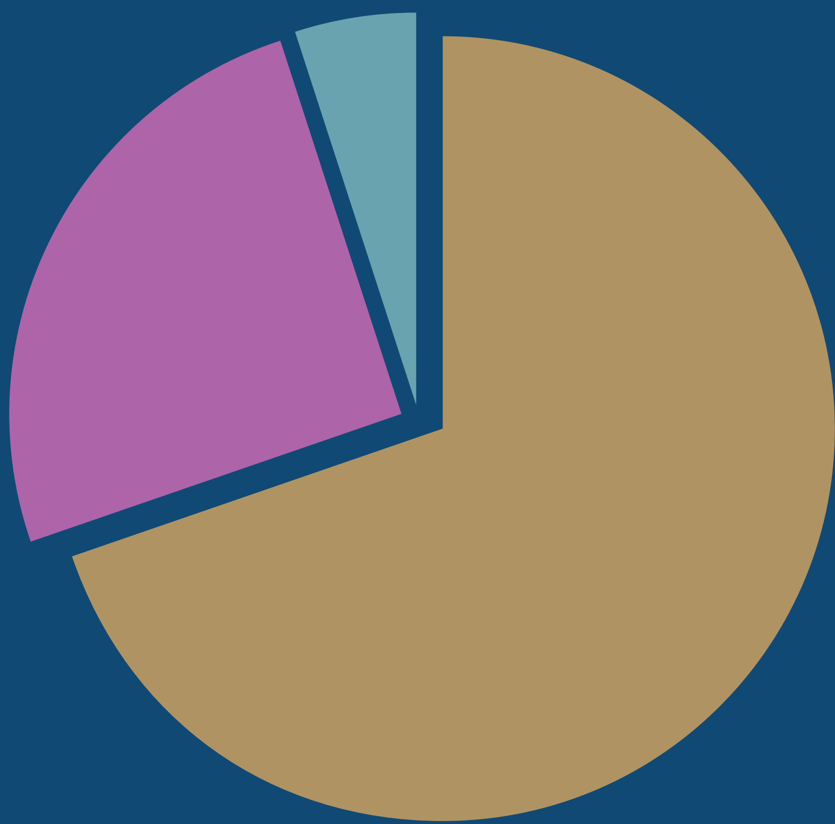
Other issues of importance to the public include UK companies paying their fair share of tax (53%) and encouraging companies to pay a living wage (51%).

The Stewardship Code

The UK Stewardship Code, first published in 2010 and revised in September 2012, aims to enhance the quality of engagement between asset managers and companies to help improve long-term risk-adjusted returns to shareholders. The Code also describes steps asset owners can take to protect and enhance the value that accrues to the ultimate beneficiary. The Code sets out a number of areas of good practice to which the Financial Reporting Council believes institutional investors should aspire and operates on a 'comply or explain' basis. The Financial Conduct Authority requires UK authorised asset managers to report on whether or not they apply the Code.

Currently just under 300 organisations have signed up to the Stewardship Code and published a statement of commitment to the Code. The NAPF in October 2013 published a Stewardship Disclosure Framework and invited all asset manager Stewardship Code signatories to complete one for their firm. The Framework aims to more clearly illustrate the different approaches different firms take thus enabling pension funds and the public to more easily compare and contrast asset managers and direct their money to those who most closely align with their own views on stewardship. To date just over a quarter of asset manager signatories to the Code have completed a Framework and these are publicly available on the NAPF website.

Although UKSIF strongly support the Code and believe it is a vital step in encouraging and promoting high quality stewardship we do feel that it could more explicitly highlight the risks that ESG factors can pose to businesses and the importance of monitoring these factors as a key part of good stewardship; we believe that there are additional opportunities and challenges for responsible owners resulting from climate change, resource management and social sustainability drivers and that there is a clear business case for long-term responsible investment approaches.



- Asset managers 205
- Asset owners 74
- Service providers 14

‘Looking ahead’ UKSIF’s wish list for the future of active ownership

Leadership from local authority and public pension funds
That all local authority and public pension funds will sign up to the UK Stewardship Code and provide improved levels of information on how they manage extra-financial factors

Increased demand for high quality active ownership
That asset owners will increasingly include information and capability on ownership activities in their selection of investment managers

Increased public awareness and engagement with the finance system
That as public awareness of ESG issues and how these relate to the financial sector grows investment decisions will increasingly be considered and challenged when not aligned to the best interests of wider stakeholders

That all large firms will be required to report on how their DC pension plans integrate ESG
Regulators will require all large firms to report on a ‘comply or explain’ basis how their DC corporate pension plans integrate ESG factors

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The UK Sustainable Investment and Finance Association (UKSIF) supports the UK finance sector as a global leader in advancing sustainable development through financial services. We promote and support responsible investment and other forms of finance that advance sustainable economic development, enhance quality of life and safeguard the environment. Founded in 1991, UKSIF has over 250 members including pension funds, asset managers, research providers, financial advisers, banks and non-governmental organisations. For more information, please visit *www.uksif.org*.

Aviva Investors is a global asset management business dedicated to building and providing focused investment solutions for clients which include local government organisations, pension funds, wholesale and retail banks, insurance companies, charities and private wealth managers.

We are the asset management arm of Aviva plc (AV. listed on LSE, FTSE 100), the UK's largest general insurer and one of Europe's leading providers of life and general insurance.

We employ over 1,000 people in 19 locations and 15 countries. With assets under management of c. £241 billion (as at 31 December 2013) across a range of real estate, equity, fixed income, money market, mixed and alternative funds, our clients benefit not only from our unique access to, and experience of, local markets but also from the availability of considerable global resources.

The National Association of Pension Funds (NAPF) is the leading voice of workplace pensions in the UK. We speak for 1,300 pension schemes with some 16 million members and assets of around £900 billion. NAPF members also include over 400 businesses providing essential services to the pensions sector.

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