

Executive Summary

The fundamental importance of transparency, accountability and sustainability within financial markets has shot to prominence in the wake of the crisis gripping the global economy in 2008. A myopic focus on short term profitability rather than sustainable long term growth, a failure to realistically assess business risks, along with weak governance structures in banks and financial services companies have together led to painful losses for investors. This failure to correctly understand and price risk is now wreaking havoc on the wider economy.

Fund managers are given delegated authority to make investment decisions on behalf of clients, including pension funds. These managers have the power – and we would argue the responsibility – to monitor carefully the full range of material risks to corporate performance and value. Environmental, social and corporate governance risks are amongst the key ‘extra-financial’ factors which can impact value in the short and long term. The ability of fund managers to carefully and knowledgeably assess ESG risk factors and to engage effectively with investee companies to address such risks is likely to affect their overall performance as managers of other people’s money.

In this context a detailed study of the Responsible Investment (RI) strategies and activities of thirty of the largest asset managers operating in the UK is timely. Clients with a fiduciary duty to ensure long-term returns, including pension funds, need to understand the ability and willingness of different fund managers to be responsible investors. We believe this report will provide pension funds and other clients of UK fund managers with information of real value.

Leaders and laggards

There is a striking disparity of observable performance on Responsible Investment amongst the asset managers in this year’s survey. The leaders – F&C, Insight, Hermes and Aviva Investors (formerly Morley) – demonstrate a deep commitment to responsible investment through their engagement activities and public disclosures.

In stark contrast, some of the lowest scoring asset managers give no indication of any coherent approach towards integrating ESG risks and opportunities into investment strategies, and appear to fail to meet industry best practice codes¹. The low transparency scores of some asset managers highlight a divergence between the expansive corporate social responsibility policies of parent companies and the limited demonstration of any equivalent responsible investment strategy on the part of their asset management divisions².

Significant year on year improvement

The survey shows a clear improvement in the combined performance of the 20 asset managers that were surveyed in both 2007 and 2008, as illustrated by a 23% increase in average performance and the fact that no asset manager scored a zero this year (as opposed to two last year). While the leaders continue to display a strong performance, with Baillie Gifford and Standard Life showing significant improvements in this category, last year’s bottom five have also made encouraging progress, with some of the biggest improvements achieved by Goldman Sachs, State Street, Wellington and BlackRock.

1. Best practice codes include the Institutional Shareholders Committee’s Statement of Principles and the UK Combined Code on Corporate Governance

2. For example, Lloyds TSB, Barclays and Credit Suisse all appear to have strong group CSR policy statements, but with a contrastingly low RI performance evidenced by their asset management divisions in our survey.

Emphasis on governance issues masks an absence of focus on environmental and social issues.

This year we have attempted to assess whether companies which claim to evaluate and engage on the full range of ESG issues do actually focus on environmental and social factors as well as corporate governance.

Our findings suggest that asset managers' focus on ESG more often than not is limited to governance issues such as board structure and remuneration. Of the 22 asset managers that disclosed a policy on ESG issues 19 covered only corporate governance issues, while only F&C, Insight and Standard Life could explain their policy on environmental and social factors in any detail. Similarly, on corporate engagement, although the overall score for the 30 asset managers on ESG engagement was 53%, this fell to a mere 25% when environmental and social issues were considered separately from governance. It appears as though investment analysis of environmental and social risks/opportunities is confined to a small niche in the industry. This is a significant cause for concern as the risks associated with environmental and social mismanagement by companies can be as damaging to value as governance issues both in the short and the long run³.

Impact on investee companies remains elusive

Though many of the asset managers surveyed this year appear to be actively voting and conducting engagement meetings with companies, less than half are able to show any evidence that their engagements have brought about change in corporate behaviour on ESG concerns. Only three, (F&C, Insight and Aviva Investors) show substantial evidence of change in company policy and practice (e.g. through results of benchmarking exercises, or externally corroborated reports). It is notable that, although asset managers are generally cautious to claim any causal effect of their engagements, those who are more

confident in claiming success are the ones who adopt RI in a comprehensive manner, as suggested by their high scores on all sections of the survey.

Public kept in the dark about engagement activities

More than three quarters of the asset managers in our survey do not reveal their engagement activities other than to clients. Whilst a number state a belief that full public disclosure would undermine their ability to effectively engage with companies, we note that asset managers who lead in terms of public transparency are also those with an impressive track record on effective engagement.

Correlation between dedicated resources and evidence of greater engagement

Perhaps unsurprisingly, our results suggest that a dedicated team of in-house employees to analyse and engage on ESG issues appears to add significantly to the effectiveness of asset managers as active shareholders, protecting and enhancing the long-term value of companies held.

Positive correlation between UNPRI signatories and higher ESG performance

There appears to be a strong correlation between signing the UN's Principles for Responsible Investment (UNPRI) and performance on ESG analysis and engagement: three quarters of the asset managers in the top half of our ranking are UNPRI signatories, compared to only one-fifth in the bottom-half. A number of the biggest names in the asset management industry (Barclays Global Investors, State Street, Capital International, Morgan Stanley, and Goldman Sachs) were not UNPRI signatories as at the date of our survey. Institutional clients concerned to ensure that 'extra financial factors' are accounted for in the investment process may find it prudent to encourage their asset managers to commit to the Principles.

3. Impact on value is demonstrated for example by the share price of BP following the explosion in its Texas City oil refinery in 2005, where the stock underperformed the world oil and gas sector by 10.7 per cent, as noted in the Financial Times article "More Fuel for Anti-BP Sentiment", 30 June 2006 available at <http://www.ft.com/cms/s/0/10be2944-07d5-11db-9067-0000779e2340.html>

Drivers of change

The overall year on year improvement demonstrated by the 20 asset managers who were surveyed last year indicates a growing interest in incorporating material ESG risks and opportunities into the investment process.

This can be attributed to mounting demands from multiple stakeholders – institutional clients such as pension funds⁴, regulators, retail investors and pension beneficiaries. Another significant factor would seem to be increasing public scrutiny of asset managers, of which last year's report was a part.

UK Asset Manager Responsible Investment Ranking 2008

Asset Manager		Transparency Score	ESG Engagement Score	ES Engagement Score	Total Score	% Score	Rank	UNPRI Signatory
		(max 12)	(max 16)	(max 8)	(max 36)			
Top 5	F&C Asset Mgmt	12	16	8	36	100	1	Yes
	Hermes Fund Managers Ltd.	9	16	6	31	86	2	Yes
	Insight Investment	12	13	6	31	86	2	Yes
	Aviva Investors (Morley)	9	14	7	30	83	4	Yes
	Standard Life Investments	8	12	5	25	69	5	Yes
	Baillie Gifford & Co.	9	12	3	24	66	6	Yes
	HSBC Global Asset Management	6	15	3	24	66	6	Yes
	AXA Investment Managers	6	13	2	21	58	8	Yes
	Fidelity International	7	12	2	21	58	8	No
	Newton Investment Mgmt.	7	11	3	21	58	8	Yes
	Schroder Investment Management	3	12	5	20	55	11	Yes
	Aberdeen Asset Managers Ltd.	5	11	2	18	50	12	Yes
	UBS Global Asset Management	5	11	1	17	47	13	No
	BlackRock	5	10	1	16	44	14	No ⁵
	Henderson Global Investors	6	9	1	16	44	14	Yes
	Legal & General Investment Mgmt.	6	8	1	15	41	16	No
	JP Morgan Asset Mgmt.	4	8	0	12	33	17	Yes
	Barclays Global Investors*	6	5	0	11	30	18	No
	M&G Investments*	6	5	0	11	30	18	No
	Wellington Management	1	8	2	11	30	18	No
	AllianceBernstein Institutional Invst.	2	8	0	10	27	21	No
	Capital International	1	9	0	10	27	21	No
	Morgan Stanley Asset Mgmt.	2	8	0	10	27	21	No
	Threadneedle Asset Mgmt.	4	5	1	10	27	21	Yes
	Goldman Sachs Asset Mgmt Intl.	0	8	1	9	25	25	No
Bottom 5	State Street Global Advisors UK	0	6	1	7	19	26	No
	Scottish Widows Invest. Partnership	2	4	0	6	16	27	Yes
	Artemis Investment Management*	2	2	0	4	11	28	No
	Credit Suisse Asset Mgmt.*	1	1	0	2	5	29	No
	INVESCO Perpetual*	1	1	0	2	5	29	No

* Artemis, BGI, Credit Suisse, INVESCO and M&G Investments did not actively participate in the survey; their scores are based on the information available on their public website

4. FairPensions has received anecdotal evidence from pension funds that confirm their engagement with asset managers on this issue.

5. As at 12th September 2008, BlackRock was not a signatory to the UNPRI, but we are pleased to note that it is now a signatory.

Main Report – Introduction

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activities of thirty of the largest asset managers operating in the UK is timely.

Asset managers are given delegated authority to make investment decisions on behalf of clients, including pension funds. These managers have the power – and we would argue the responsibility – to monitor carefully the full range of material risks to corporate performance and value. ESG risks are amongst the key ‘extra-financial’ factors which can impact value in the long term⁶. The ability of asset managers to carefully and knowledgably assess ESG risk factors and to engage effectively with investee companies to address these risks is likely to

‘Ethical Investment’ and ‘Responsible Investment’ (RI)

Ethical investment generally refers to investment strategies based on asset allocation – either screening out ‘bad’ sectors or companies, or specifically seeking ‘good’ companies and sectors to invest in. Responsible Investment (RI) may incorporate an ethical approach, but generally refers to the overarching policy and practices necessary to monitor and manage opportunities and risks arising from ‘extra-financial’ factors including environmental, social and governance (ESG) issues. Transparency and engagement (active ownership) are generally considered to be the key elements of RI.

Transparency, through public disclosure, is imperative for demonstrating and exercising accountability. Lack of transparency makes it difficult for individuals such as pension fund beneficiaries to discern if fund managers making investment decisions on their behalf are addressing any negative social and environmental effects of their investments and the potential risks presented by these concerns.

Active ownership implies that as owners of a corporation, shareholders have the right and the responsibility to influence a firm’s strategy and its management of risks. This is primarily done by exercising voting rights, and in the case of institutional investors, engaging with companies to discuss risks including ESG issues. These methods are less effective in isolation. For example, engagement has more influence if there is the option to exercise a relevant vote, and voting has more impact if it is associated with communication to explain concerns. The ultimate sanction of selling a share may be necessary if the risk is sufficiently large and the company unresponsive.

6. UNEP FI’s 2007 report entitled Demystifying Responsible Investment Performance cites detailed academic and brokerage firm studies that show a positive association between the inclusion of ESG criteria and enhanced financial performance. The report is available at http://www.unepfi.org/fileadmin/documents/Demystifying_Responsible_Investment_Performance_01.pdf

affect their overall performance as managers of other people's money. So long as ESG issues can be material to a company's long term valuation, any prudent risk management and decision making strategy will benefit from integrating ESG analysis into the investment process.

Those with fiduciary duties, including pension funds, need to understand the ability and willingness of different asset managers to be responsible investors⁷. We believe this report provides pension funds and other clients of UK asset managers with information of real value. The report assesses the current RI

policies and practices of asset managers in the UK with approximately US\$ 22 trillion under management⁸. It builds on a similar survey conducted last year, with ten asset managers added in 2008, in addition to the twenty surveyed last year.

The survey findings show a discernible trend, albeit the signs are intermittent, that the asset management industry is increasingly recognizing RI as an integral part of future-proofing investee companies and increasing its integration of ESG factors into mainstream analysis. There is, however, still a long way to go.

7. Since the publication in 2005 of a widely acknowledged legal opinion by Freshfields Bruckhaus Deringer, (commissioned by the UN Environmental Programme Finance Initiative) it has become apparent that institutional asset owners such as pension funds may be in breach of fiduciary duties to their beneficiaries if material ESG considerations are not factored into the investment process. The report is available at http://www.unepfi.org/fileadmin/documents/freshfields_legal_resp_20051123.pdf

8. Please see appendix 2. re methodology