Association of Member Nominated Trustees

28 October 2020

Mel Stride, MP
Chair of the Treasury Select Committee
Via email

RE: Inquiry into decarbonisation and green finance

Dear Mr Stride,

I am writing to you on behalf of the Association of Member Nominated Trustees (AMNT) in relation to oral evidence that you have heard from the Financial Conduct Authority (FCA) on the 30th September 2020 and the Association of British Insurers and Aviva on the 14th October 2020. We wish to comment on this.

First, we would like to thank Harriet Baldwin MP for asking the FCA about our Red Lines issue. She reminded Sheldon Mills of the FCA's letter to the committee last March regarding the failure of the fund management industry to allow pension scheme trustees to operate a stewardship policy, and asked for an update.

In his answer Mr Mills stated:
"The way we currently think this should be solved is for a greater level of interaction between asset owners, asset managers and trustees, which is part of the stewardship work we are working towards, with more transparency and information on the reasoning behind the voting intentions that come there. Often, people will move to the simplest logical solution, which might not be the best one, that trustees should just be able to direct asset managers to vote in the way that they see.

"We know that, in a sense, asset managers need to think about how their overall voting power is used in that space. If you are an asset manager who ends up splitting your vote across different views of different trustees, it may be potentially counter to our aims here, because that split vote may not give the right message to the firms involved. It is a complex area. We recognise that these are real concerns and are working to bring together the actors here to ensure that there is a solution."

To our knowledge there has been no progress at all since March that we are aware of on the part of the FCA. The FCA's view that the problem can be solved by fund managers giving more information and reasoning behind their voting intentions will, in our view, achieve nothing.

The problem is that pension scheme trustees have increased expectations to be active stewards of the companies in which they invest. If the trustee has identified certain environmental, social and governance (ESG) issues as financially material, then they are required to incorporate them into their investment strategy, and hence developing an ESG policy (including on stewardship matters such as voting). However, virtually all those that invest in pooled funds continue to be prevented by their fund managers from having their voting policies adopted on a comply or explain basis.

This is an enormous issue. According to the Investment Association, of the £8-trillion of assets under management in the UK, nearly half of it, £3.8-trillion, is in pooled funds. The fund management industry would like to maintain exclusive control of voting policies associated with this £3.8-trillion.

This untenable situation is made worse by the fact that the fund management industry is not at the forefront of action against climate change. For example, one of the key policies of the AMNT's Red Line voting policies aims to drive corporate change over a three-year period. It proposes a vote against the chair of the environmental sustainability committee, or the chair of the board if the company does not have such a post, if the company has failed to introduce and disclose emission reduction targets. Year 2 we propose the same vote if the company has failed to commit to introduce and disclose science-based emission reduction targets with a coherent strategy and action plan in line with a 2 degree scenario. Year 3 we propose the same vote if the company has failed to actually introduce and disclose the above.

Compare this with the voting policies published by the fund managers. AMNT's 2019 review into the voting policies of fund managers found that over half of the fund managers did not have a climate change-related voting policy or guideline[1]. And even when they did have a voting guideline, most of them stated that they will consider supporting shareholder resolutions. Since hardly any shareholder resolutions are proposed at UK company AGMs those fund managers' stated policies are in effect not to vote at all in relation to climate change at almost all corporate meetings. It is as if the fund managers are standing in front of a burning building and saying they will help put out the fire if someone is prepared to pass them a bucket of water.

So most pension scheme trustees that have adopted AMNT's clear policy on climate change, developed with advice from the Carbon Disclosure Project, will be faced with a fund manager that not only has an inferior policy but also refuses to adopt that of their client.

The FCA's solution to this problem, as expressed at the oral hearing, appeared to be that fund managers should merely explain their own policies more clearly and be more transparent. This implies that the fund managers' policies are the correct ones and the asset owners' concerns can be allayed by explaining them in more detail.

Our own research has demonstrated that this is not the case, as shown above. Many of the fund managers' policies on a range of issues are weak or non-existent.

The FCA also passed on to you fund managers' concerns that splitting the vote at a company AGM '*may not give the right message to the firms involved'*. AMNT disagrees. Firstly, on a matter of principle, the "right message" is one that comes from one who has the assets – the trustees. Put simply – it is not the fund managers' money. Secondly, it

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[1] https://amnt.org/amnt-identifies-poor-transparency-in-fund-manager-voting-policies-and-practices/

serves no purpose to allow a fund manager to cast all their votes with one voice if their voice is sending the wrong message. Intermediaries should not be given the power to dictate the voice of trustees.

It is clear that there is now a direct clash of interests between asset owners and investment managers in this area. The growing regulatory requirements on pension scheme trustees make it inevitable that fund managers will have to move with the times, change their business models, and allow trustees to direct a voting policy and act on it on a comply or explain basis, reporting to the client on any instances where they have not followed the client's voting policy. It is disappointing that the FCA appears to be siding with those who are resistant to change. However, we were pleased to see Anthony Raymond of the Pensions Regulator state: "It is key that the wishes of trustees and their voting wishes are reflected by the asset managers".

Turning to the second set of oral evidence, from the ABI and Aviva, we wish to comment on their suggestion that the charge cap on workplace pension fees will have to be lifted for the industry to transition to a low carbon economy. They state that ESG funds are typically above the 0.75% cap because they involve active management so are more expensive to run, and so if there is an ESG component in assets then the charge cap should be lifted.

The AMNT recalls the financial services industry's opposition to the charge cap when it was first introduced so the current call is no surprise. We wish to remind the committee of the FCA's asset management market study which stated that they found evidence of sustained high profits over a number of years and set out a package of remedies intended to address this. We also note the latest Investment Association annual report which states: "*Total average net revenue stood at £22.9-billion, representing 28bps of total assets … Profitability based on headline data stood at 31%.*"

The AMNT continues to support the charge cap as an essential protection for pension scheme members and an important constraint on the financial services industry which has a long way to go before it finds itself in the same situation as too many pension scheme members, needing to think twice before they turn the heating up. We believe that any lifting of the charge cap will be acting against the direction of travel, which is to encourage the lowering of fees.

We would be happy to engage with you further on this topic should you wish.

Kind Regards,

Janice Turner, Co-Chair
AMNT