FT Series **The responsible capitalists**

Ethical and responsible investment

How asset managers turned into business agitators

A change of heart about investing that looks beyond profits seems to have taken hold

© FT montage / Bloomberg

Attracta Mooney in London YESTERDAY

For decades, fund managers making investment decisions have focused on financial performance to the exclusion of almost everything else.

In the good times they reaped sizeable dividends from the likes of oil and tobacco companies, with little concern about the potential long-term impacts of the businesses they financed.

But a change of heart about investing that looks beyond cold hard profits has taken hold to such an extent this year that Anne Richards, the boss of fund management behemoth Fidelity International, told a room full of 200 financial executives in November that the industry had to change.

"We as investors . . . must adapt to the realities of today. To slow this rapid destruction of our shared home, we will need to rethink the very purpose of our economic systems," she said.

"The pressure is coming from all around. It's hard to find voices that defend 'business as usual' and actually even capitalism as a concept."

ASSET AGITATORS

Although there was always a small band of fund managers who were interested in whether the businesses they bought shares in were part of the "doing good while doing well" category, many of the big names have now tuned into these questions too in response to pressure from politicians, the public and, most of all, their clients.

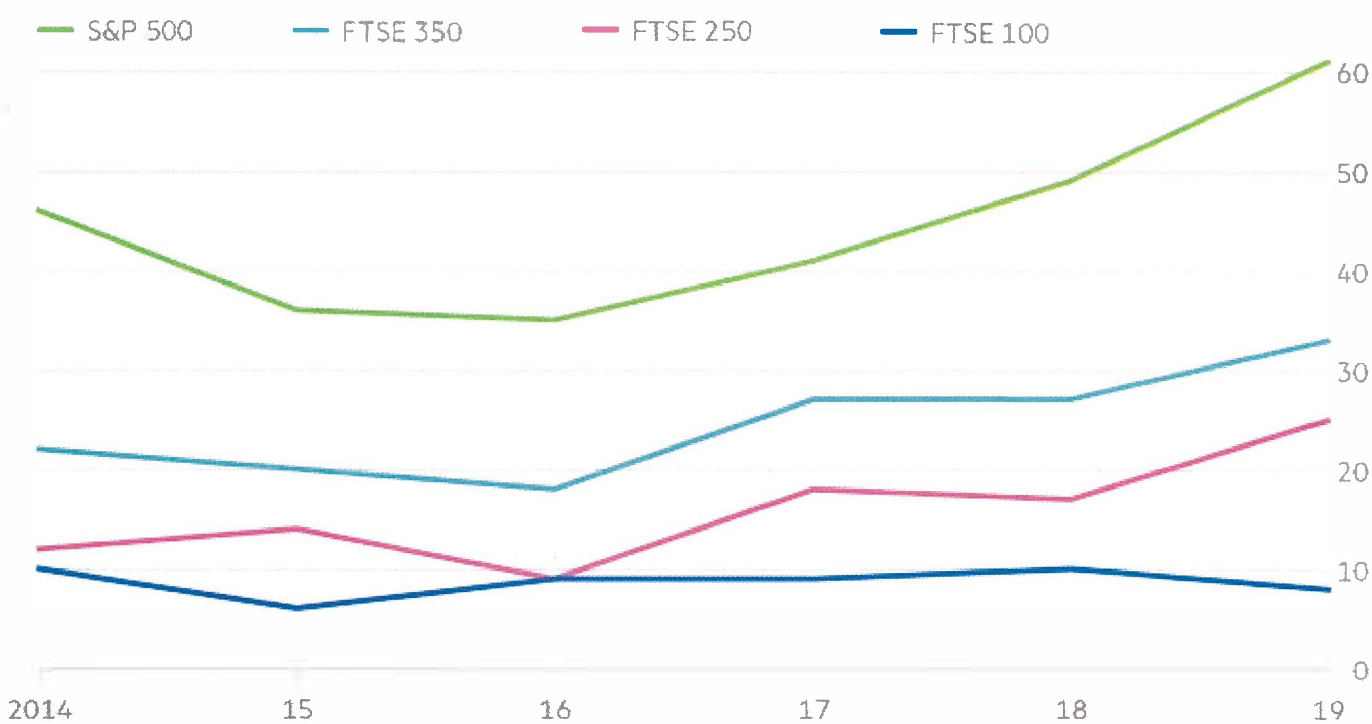
Pension funds, which are by far the biggest clients of asset managers, are increasingly asking them tough questions about the businesses where they have shareholdings. In the UK, new rules were introduced in October this year that in effect require pension funds to consider ESG — environmental, social and governance — questions in their investment decisions.

Because of this pressure from clients, asset managers in turn have become the main agitators for businesses to change their ways in recent years, pushing chief executives for reform on everything from high pay to environmental disclosures.

"The investor voice has been key" to changes, particularly on questions of sustainability, said Tim Smith, director of ESG shareholder engagement at Walden Asset Management.

Pay disputes are on the rise

Number of revolts*



* Revolts classed as 20%+ opposition
Source: Proxy Insight
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Andreas Utermann, chief executive of Allianz Global Investors, the €557bn asset management business of German insurer Allianz, said: "Clients have changed their tune. They have said we need to take this more seriously and that has sharpened the minds of the asset managers."

The changing priorities of younger age groups is also driving the change in focus. According to data from research company Cerulli Associates, more than two-thirds of investors under 30 would prefer their investments to have a positive social or environmental impact.

With rising demand from clients, asset managers have spent the year pouring money into hiring staff and upgrading their technology systems in a bid to gain an edge in ethical investing.

They have also done more to make their views known to company boards and are more willing than ever to use their votes at annual meetings to signal disapproval. At the same time, a number of investor groups have sprung up, with the aim of improving standards in areas like workers' rights and environmental disclosure.

HIGH PAY AND OTHER PRESSURE POINTS

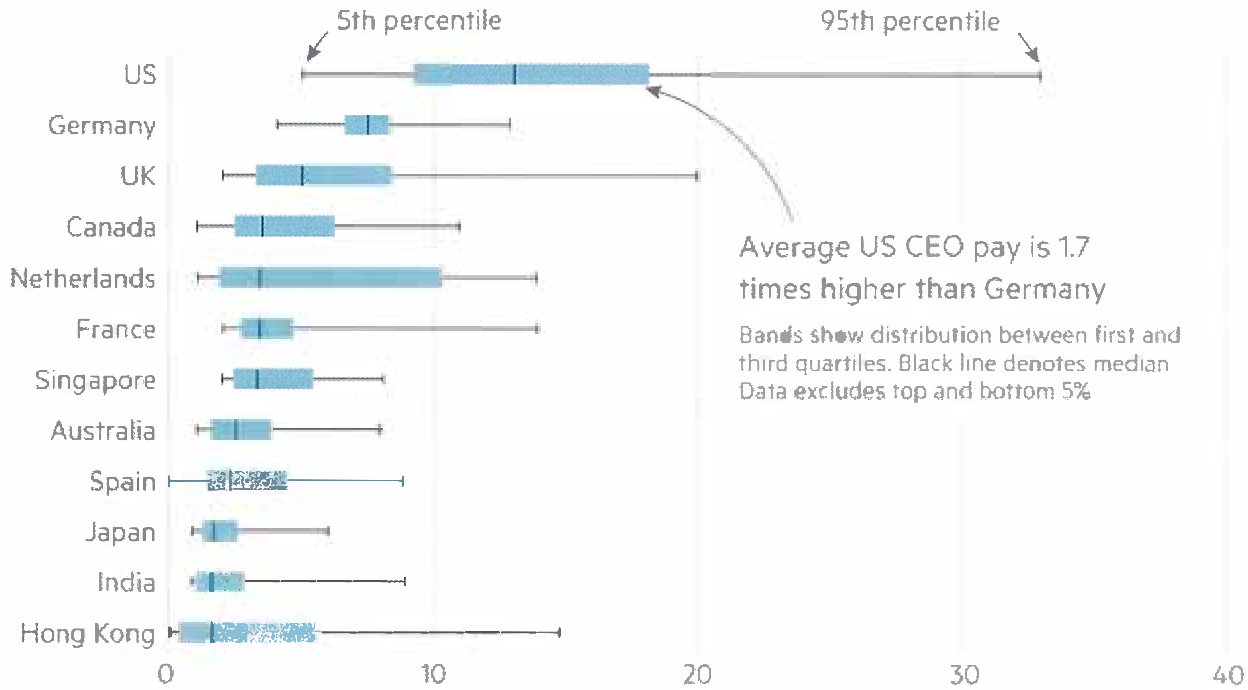
What all of this means is that listed businesses face shareholder scrutiny like never before and so far the biggest battles have been about pay.

There were shareholder revolts against pay at 33 of the UK's 350 biggest listed companies this year, up from 22 in 2014. At the same time, average shareholder support for executive pay packages at UK-listed medium and large public companies has come down every year since 2014, according to data provider Proxy Insight.

A number of top executives at British banks have also been forced to accept cuts to their pension payments to bring them more in line with their wider workforce, after pressure from shareholders.

US CEO pay dwarfs other nations

Median annual pay ($m)



Source Bloomberg
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*Based on latest figures from each country's benchmark index

A similar trend has played out across the S&P 500 in the US, with shareholder revolts over pay rising from 46 to 61 since 2014.

Investors have also been more involved this year in putting pressure on fossil fuel companies such as BP to improve their environmental disclosures.

"The financial markets are becoming a powerful force in the drive towards sustainability," said Anne Simpson, investment director at Calpers, the US's largest public pension fund. "The reason is simple. The long-term drivers of risk and return ride on companies' ability to manage their human capital, their physical resources. It is not enough simply to deploy finance with flair."

Ms Simpson said employee and human rights had also moved up the agenda. Calpers is a founder of the Human Capital Management Coalition, which put pressure on fast-food and retail companies to tackle low pay this year. Companies including McDonald's and Target raised wages in response.

In the US, a human rights resolution also won the backing of a majority of shareholders for the first time ever, according to Proxy Insight. Just over half of shareholders at Microchip Technology's annual meeting in August supported a motion calling for a report on human rights risks to employees in the company and across its supply chain.

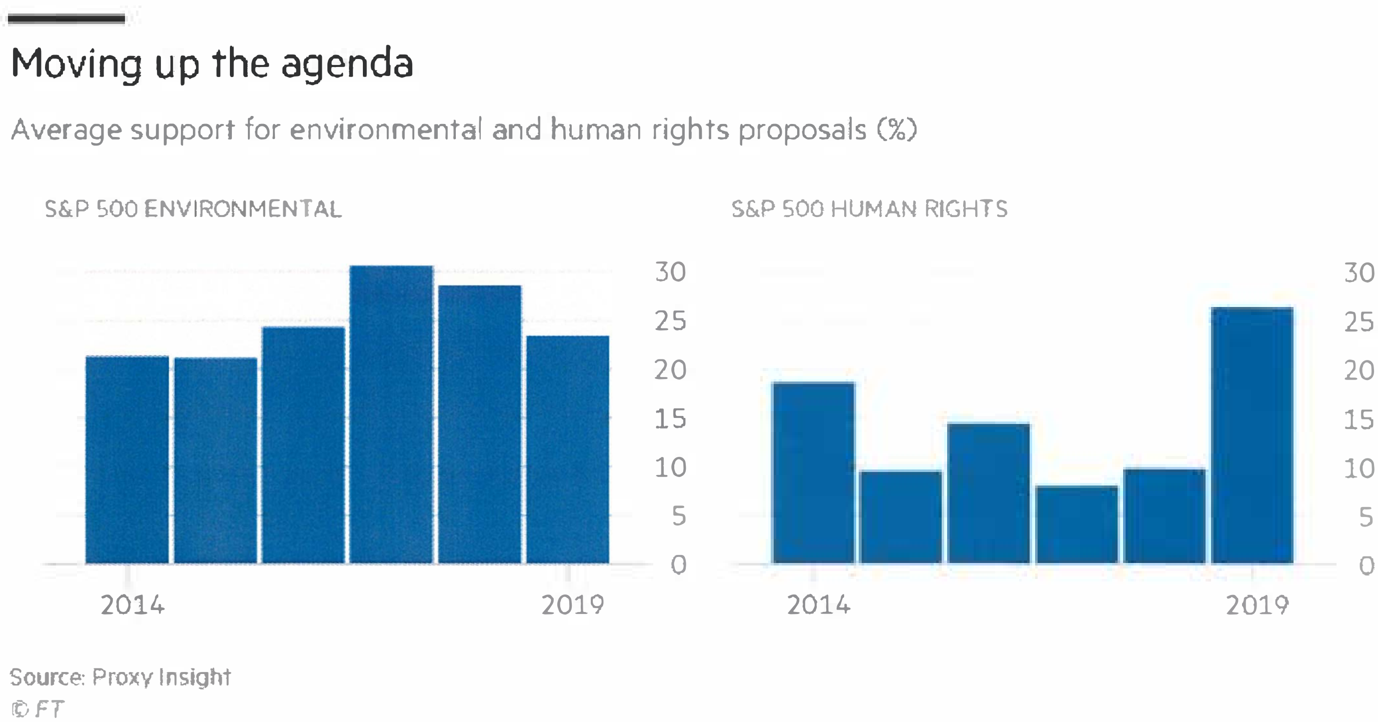
There are also signs that investors are becoming more willing to dump companies with bad ESG records. Union Investment, Germany's third-largest asset manager, sold its bonds and shares in mining company Vale after a dam collapse in Brazil that killed 272 people in January, as did the Church of England's Pensions Board.

Elsewhere, Norway's $1tn oil fund, the world's largest sovereign wealth fund, sold out of security company G4S this year on ethical grounds, after it said it found that the company's migrant workers in the Middle East were being harassed, had their passports confiscated and were being paid lower wages than agreed.

BUT IS DOING GOOD HERE TO STAY?

The question now is whether 2019 marked a clear shift in how the asset management industry operates. Ajit Dayal, founder of Quantum Asset Management Company, said ESG investing was not high on the agenda in Asia. "It does not exist in India. Fund managers just want to make money."

Talking at an event in London this month, fund industry veteran Helena Morrissey said she worried that some asset managers were paying only "lip service" to sustainable investing.



"There is a lot of marketing of [funds] with ESG considerations but [some asset managers] aren't following through with this in engagements with companies."

According to a global Edelman study of 600 investors published this year that looked at the most important attributes for a company's long-term valuation, fund managers ranked ESG fairly low, far behind growth strategy.

But others believe the change will persist and spread. Sarah Wilson, chief executive of Minerva, a proxy advisory company that provides services to shareholders, said that since the financial crisis there had been an "absolute paradigm shift" in how fund managers thought about investing.

"There are pockets of resistance, people who don't believe these things make a difference. The way fund managers were taught to think about fund management was very narrow, but that particular paradigm has been broken," she said.

Mr Utermann agreed that the focus from investors on ESG had changed the investment industry. "When shareholders started engaging with companies on these issues, environmental or other ESG issues, that gave them an opportunity to take their gaze away from short-term metrics and look at how they could differentiate themselves," he said.

Sustainable investing and the pressure on companies to do good is here to stay, he believes. "[It] is really a matter of survival. There is a realisation and a conviction that if asset managers don't address those broader concerns that stakeholders have, you won't survive. And most leaders in this industry know that now."

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The year capitalism went cuddly

German bosses question US pledges on corporate reform

Fire and flood focus minds of bosses and investors