Appendix A(i)

INSTITUTIONAL INVESTORS AND THE FINANCIAL CRISIS

- We note the letter sent in January 2009 to the Prime Minister by the TUC and other high-profile signatories about the role of institutional investors – particularly pension funds – in addressing the current financial crisis (see attachments).

- We also note Lord Meyners' comments to the Observer newspaper in January 2009, calling for institutional investors to be more active in engagement with the major financial institutions in which they hold shares (see attachment).

- We also note that the Pension Fund Annual Report 2007-2008 reported that, on 31 March 2008, the Fund held at least £60.8 million of equity shareholdings in banks and financial institutions (HSBC Holdings, Royal Bank of Scotland, HBOS, Aviva).

- We also note that in the Report on Investment in Burma that went to the Pension Fund Management Board on 16 May 2008, it was recommended that the Socially Responsible Investment Policies of existing investment managers were looked at again in the "not-too-distant future".

We therefore ask that

A. The Fund's Statement of Investment Principles is reviewed, particularly with regards to Socially Responsible Investment, Corporate Governance and Exercise of Voting Rights (see attachment), and to the Pension Fund Management Board's role in monitoring the investment managers' performance in these areas.

B. The Fund takes a lead by implementing the first two steps recommended in the report sent to the Prime Minister by the TUC.

C. The Socially Responsible Investment policies of existing and future investment managers are critically reviewed and improvements called for as necessary.

Attachment to Appendix A(i)

Extract from Statement of Investment Principles

4.1 Socially Responsible Investment (SRI)

The Pension Fund Management Board has considered social, environmental and ethical issues in the context of the Fund's investment strategy and their responsibility to safeguard the best financial interests of beneficiaries. The Board recognises that involvement by individual companies in activities that may be considered unacceptable could lead to a poor share price performance.

The investment managers have produced statements setting out their policies on these issues. Having reviewed these policies, the Board has decided to delegate investment powers to the managers to act in accordance with their statements, in pursuit of the investment strategy set by the Board. It is expected that the managers will attempt to influence the behaviour of companies in this area where they can identify a possible impact onto the share price.

4.2 Corporate Governance/Exercise of Voting Rights

The Pension Fund Management Board recognise that votes attaching to the Fund's shareholdings are a valuable asset, and expect to see their shareholdings voted in a considered manner. Wherever practical and cost effective, all available votes should be cast.

The exercise of voting rights is, however, only part of the way in which shareholders can influence companies to take action that ensures that share price performance can be optimised. All managers have produced statements in terms of their policies in relation to Corporate Governance. These policies have been reviewed by the Board and responsibility for Corporate Governance (including the exercise of voting rights) has been delegated to the managers on the basis that voting powers will be exercised with the objective of preserving and enhancing long term shareholder value.

The managers have been specifically instructed to vote against any resolution relating to the payment of political donations by a company.

The Pension Fund Management Board has requested the investment managers to report any significant issues in respect of SRI or Corporate Governance on a regular basis.

Trades Union Congress

Rt Hon Gordon Brown MP
10 Downing St
London
SW1A 2AA

date: 14 January 2009
contact: Alice Hood
direct line: 020 7467 1225
email: ahood@tuc.org.uk

Dear Prime Minister

Institutional investment and the financial crisis

We believe that in the context of the current financial crisis, the role of the major institutional investors – particularly pension funds – in holding companies to account is critical. But it has been overlooked in much of the public and media debate.

The attached statement sets out some of the key issues and proposes some steps that we believe would help to address some of the shortcomings that have contributed to the current situation and rebuild a more sustainable financial system.

We would greatly appreciate your support for these proposals, and look forward to hearing your views on the issue.

Yours sincerely

Brendan Barber

Brendan Barber,
TUC General Secretary

John McFall

John McFall MP,
Treasury Select
Committee Chair

Terry Rooney MP, Work
and Pensions Select
Committee Chair

cont.

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General Secretary: *Brendan Barber* Deputy General Secretary: *Frances O'Grady*
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TUC

David Pitt-Watson, founder of Hermes Stewardship Services and author of *The New Capitalists*

Matthew Taylor, Chief Executive, RSA

Peter Webster, Executive Director, EIRIS

Will Hutton, Chief Executive, Work Foundation

Catherine Howarth, Executive Director, FairPensions

Alan MacDougall, Managing Director, PIRC

Colin Melvin, Chief Executive Officer, HERMES Equity Ownership Services

Ian Jones, Head of Responsible Investment, CIS Asset Management

Copies to: Rt Hon Alistair Darling MP
Rt Hon James Purnell MP
Paul Myners CBE

Attachment to Appendix A(ii)

Addressing the Financial Crisis - the Responsibilities of the Major Shareholders

As the financial crisis continues to unfold, there has rightly been considerable attention paid to the role of bankers and regulators in the unravelling of the financial system. However, the role of investors - particularly the major institutional investors such as pension funds - is also central to the emerging debate on how to repair financial markets and prevent a repeat of the recent crisis.

We, a group of individuals who have long been concerned with investment issues and their impact on ordinary people and pension scheme members, believe that measures to promote responsible, long-term share ownership are an important component in creating a sustainable financial system. Today we are calling on the pensions industry and the Government to take steps to ensure that pension funds play their part in this. Such a system must promote the interests of both the companies whose shares are bought and traded and the beneficiaries with whose money investment decisions are made.

We note that recent reforms have improved the transparency and accountability of companies to their shareholders. But without incentives or requirements for investors to act on the information that is provided and ask constructive questions about the long term prospects and risks for the company, this extra transparency can be rendered meaningless. We believe this flaw in making the government's goal of "enlightened shareholder value" a reality has contributed to the current financial meltdown, the full impact of which in terms of pensions and jobs is still emerging.

We also note the existing legal obligations placed on trustees to invest predominantly in regulated markets and to invest in derivative instruments only for the purpose of minimising risk or achieving efficient portfolio management. It is clear that risks to schemes are bound up with risks to the system as a whole, and we therefore believe that there is a need for these obligations to be more clearly embedded in the principles and practice that inform investment decisions, and to include issues of systemic risk.

We believe it is now time for pension fund boards to think hard about the records of the firms they own. Recent events have shown how the failure to hold corporate leaders to account for their decisions about risk can have a catastrophic effect on the financial system, the economy, the corporations themselves and ultimately on the well-being of members of pension schemes. We also believe strongly that the same can be said of bad governance, poor labour standards and environmentally unsustainable practices. Like financial mismanagement, these factors have also been shown to have a real impact on a company's bottom line - and therefore on the returns for institutional investors such as pension funds.

As such, building an understanding of these risks into investment decision making and into engagement with firms is an essential responsibility of pension funds and the managers who invest funds on their behalf. Boards of trustees of pension funds need to develop clear policies and guidance mandating their fund managers to engage in dialogue with companies, to vote at company AGMs and to report back on what impact their engagement has had. Alternatively, if fund managers are unable to do this, boards can delegate responsibility for this engagement to a third party.

With this in mind, we are calling for the following steps to be taken.

1. Pension funds should insert a "do no harm" clause into their statement of investment principles (SIP), requiring fund managers and other advisors to satisfy trustees that their investment decisions are not causing systemic harm to the stability of the financial system and therefore to the long term interests of their beneficiaries.

2. Institutional investors, particularly the large pension funds, should sign up to the United Nations Principles of Responsible Investment (PRI) as soon as possible. The PRI sets out a series of broad commitments for the engagement of investors with firms around corporate governance, environmental and social performance; it now has over 400 signatories, representing US$15 trillion in assets.

3. A collective reporting and monitoring body should be established to ensure institutional investors are acting on commitment 1. One way to do this would be to broaden the remit of the Investment Governance Group set up as a result of the recent review of the Myners Principles.

We believe that the current crisis is of such magnitude that if satisfactory progress is not made on these points by the end of 2010, the Government should consider action to make engaged investment, specifically in line with point one, a statutory responsibility for pension funds.

At the same time, there will be a major opportunity for the Government to take a lead on this issue by developing a responsible and engaged investment strategy for the new national pensions saving scheme known as Personal Accounts which will be launched in 2012 and whose funds are likely to reach 200-300bn pounds by 2050.

Appendix A(iii)

Myners tells shareholders: get tough

- Nick Mathiason, business correspondent
- The Observer, Sunday 11 January 2009

Lord Myners, the financial services secretary, has strongly criticised big investors for failing to crack down on excessive boardroom pay or raise questions over the doomed business strategies of major financial institutions.

Speaking exclusively to the Observer, Myners issued a call to arms to shareholders to take an aggressive stance towards companies in which they hold shares, in an effort to revive the global financial system. "I'm disappointed there's not more evidence that institutional investors have been seized by the challenge of addressing the shortcomings that have emerged in corporate governance as a result of this crisis," the minister for the City of London said.

"Institutional shareholders need to be asking themselves: were they appropriately engaged in asking questions about the risk appetite of our banks? Were they asking sufficient questions about competency of directors, and were they appropriately engaged in examining and approving compensation cultures?"

Myners expressed disappointment that organisations such as the Association of British Insurers have not taken a harder line against quoted banks.

"There must be a challenge put to investors that they failed to query the irrational exuberance that we now see as characterising the age of irresponsibility. Now there's a danger of 'reckless caution', and I don't see evidence they are much concerned about that either. If banks now lack the self-confidence to extend credit, this is going to cause further damage in the portfolios of our institutional investors."

Royal London Asset Management's authoritative chief investment officer, Robert Talbut, said: "If shareholders really want a strong voice, I think they will need to have the ability to hold management to account. I think there's a sense that we have not done a good job preventing the excesses. [We must be] more demanding, prepared to say 'no', be intrusive and ensure we are appropriate guardians of people's money."

Defending charges that the government's £37bn bail-out package to banks has failed to extend credit to businesses and consumers, Myners said: "The test that the package worked is whether confidence has returned, not to the credit markets, but to banks themselves."

Myners said last October that the financial system had come close to collapse. "We were in an uncomfortable place. The action which Alistair Darling and Gordon Brown took did a huge amount to stop [collapse] occurring."