I. Key points

- Universal owners have incentives to reduce negative externalities and increase positive externalities across their investment portfolios, which are likely to have long-term effect on business results.
- The largest public pension funds have a duty to take part in the externalities’ management debate because (a) there is a business case for doing so, (b) they have a fiduciary responsibility to their members, (c) they have to attract new members and (d) they are less likely to have conflict of interest than corporate pension funds, insurance companies and fund managers.
- Investment consultants, the gatekeepers on the UK and US markets, tend to see ESG factors as ones that are of interest to a minority of clients or that are about niche fund managers.
- The power that pension funds have to engage with companies is very limited compared to the potential it has if there is a collaborative effort.
- The authors present four possible opportunities for pension funds to work together:
  - **Pension Fund Futures**: pension funds’ trustees and executives would identify major externalities and market failures, outline effective ways to address these issues and build commitments to change.
  - **Principles for Responsible Investment project**: the project can be benefited from (a) expanding the focus to consider other issues rather than the traditional ESG issues, such as innovation and M&A; (b) develop a process of prioritisation; (c) support existing projects, such as the Marathon Club; (d) develop a governance structure that reflects investors’ interest and (e) motivate members to continuous improvement.
  - **Amplify the signals to investee companies**: the authors suggest to work on direct engagement with companies’ sell-side research process and with the fund management industry.
- **Engagement with companies**: encourage regulators and standard-setting bodies to push forward the agenda on extra-financial reporting
- **Sell-side research**: the Enhanced Analytics Initiative has proved to be an effective initiative to demand sell-side analysts to provide the buy-side with research that consider long-term investing and extra-financial factors
- **Fund managers**: pension funds can require their fund managers to engage with companies in a joint effort on their behalf
  - Legitimacy through consultation and collective learning: pension funds can be legitimised to act if they involve their members in strategic decision making. Beneficiaries could be encouraged to suggest potential issues for shareholder activism. Such list could then be short-listed based on priorities and made public.

## II. Key quotes

- “Complex market transformation is unlikely to be achieved by a single pension fund acting alone, even if it is very large” (Monks and Sykes 2006 in Thamotheram and Wildsmith 2007, p. 440).
- “However, working collectively large funds could have a cost-effective and profound impact, initiating changes that could increase long-term market returns by transforming value-destroying parts of the system” (Thamotheram and Wildsmith 2007, p. 440).
- “Looking forward, the practical goal should be to ensure that projects like Pharma Futures and IIGCC are no longer seen as innovative, but become ‘business as usual’” (Thamotheram and Wildsmith 2007, p. 440).
- “According to the New Economics Foundation, ‘the huge profits reported by oil and gas companies would turn into losses if the social costs of their greenhouse gas emissions were taken into account’” (Simms 2006, p. 1 in Thamotheram and Wildsmith 2007, p. 441).
- “…a recent UK government study warned that ‘over 70 million Africans and an even greater number of farmers in the Indian subcontinent will suffer catastrophic floods, disease and famine if the rich countries of the world fail to change their habits and radically cut their carbon emissions” (McSmith 2006, p. 1 in Thamotheram and Wildsmith 2007, p. 441).
- “…passive fund managers have no major business interest in the general quality of reporting on extra-financials and all active managers (including in-house managers) believe weak corporate transparency and market inefficiency favours them” (Thamotheram and Wildsmith 2007, p. 444).
- “EAI members agree to allocate a minimum of 5 per cent of their commissions to those sell-side firms that are providing the buy-side with information that genuinely meets their long-term investing needs by effectively covering extra-financial factors and influencing corporate behaviour in these areas” (Thamotheram and Wildsmith 2007, p. 444).
“...extra-financial factor are those fundamentals that have the potential to impact companies’ financial performance in a material way and which are not generally captured in investment decisions” (Thamotheram and Wildsmith 2007, p. 444).

About the Enhanced Analytics Initiative: “The number of research providers producing relevant extra-financial analysis increased from 17 to 31 in the 12 months following the December 2004 Baseline Evaluation” (Thamotheram and Wildsmith 2007, p. 444).

“...the sell-side displays a ‘dedicated blindness to capital’s collateral consequences, an indifference to the future of society even as they search for the future’s returns” (Greisner 2003, p. 1 in Thamotheram and Wildsmith 2007, p. 444-445).

“EAI is also evidence that the sell-side can be influenced by simple market mechanisms to change the nature of the conversations mainstream analysts have with companies” (Thamotheram and Wildsmith 2007, p. 445).

“The typical pension fund member is far removed from the investment and governance decision-making that happens on his or her behalf. Many of them are unaware of the potential influence the largest funds could have on the way the global economy develops, and how this could influence both their quality of life in retirement and the future their grandchildren inherit” (Thamotheram and Wildsmith 2007, p. 446).

“It is noteworthy that many pension funds believe there to be premium for corporations who have active owners and there is no reason why the same could not apply for pension funds themselves” (Thamotheram and Wildsmith 2007, p. 446).

“Never doubt that a small group of thoughtful, committed people can change the world. Indeed, it is the only thing that ever has” (Margareth Mead in Thamotheram and Wildsmith 2007, p. 448).
Thamotheram, R., & Wildsmith, H., Increasing long-term market returns

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