Raising the Standard:
Best practice on Principle 1 from Standard Life

Summary

Julie McDowell is Head of Socially Responsible Investment at Standard Life Investments, the asset management business of the Standard Life group. Standard Life plc is a $325.2bn (as at 30th June 2008) UK asset owner and signed the PRI in October 2006. Julie has been working in the field of SRI for 9 years and in this interview offers her experience and unique perspective as a manager at the heart of the industry.

Julie discusses the approach Standard Life takes to implementing Principle 1 – the incorporation of ESG issues into investment decision-making and ownership practices. Standard Life's approach includes the following key elements:

1. a Corporate Governance team that understands the investment approach used by its fund manager colleagues and how to fit in with that process;
2. support at board and senior management level;
3. both formal and informal processes for incorporating ESG issues in the investment process and;
4. a joined-up approach to research and engagement.

Julie also discusses how Standard Life co-ordinates throughout the group and offers her views on some of the challenges ahead for the responsible investment sector in the wake of the global financial crisis.

EDITED TRANSCRIPT

PRI: So how big is the responsible investment team at Standard Life and what factors do you think help you implement Principle 1?

Julie: Our Corporate Governance Team has seven full time professionals working on ESG issues. Many of us have experience that is particularly valuable to achieving our goal of incorporating ESG issues into investment processes. For example, three members of our team have fund management experience. My own 'first career' was spent working in securities, corporate and banking law on Wall Street and international trade at the US Department of State.

We believe that the professionalism of our team enables us to work successfully with our colleagues to integrate ESG to promote the best interests of our clients.

It is significant that the Standard Life group has made corporate responsibility a high priority. Our group Chairman also chairs the Standard Life Board's Corporate Responsibility Committee, which meets regularly to monitor group wide implementation of our corporate responsibility programme. Being a responsible investor is a key aspect of our CR commitment. The Board of Standard Life Investments has approved our guidelines on Corporate Governance and SRI (published at http://www.standardlifeinvestments.com/content/cg_sri/corporate_governance/principles_and_policies_index.html). The endorsement of our work at these senior levels ensures that we have the resources and support to be effective and influential.

Finally, we have been actively involved in corporate governance issues for a long time – the team was formed in the 1990s. This long experience has established the importance of governance in our corporate culture.

PRI: So can you quantify what sort of percentage ESG data plays in your decision-making process?

Our investment decisions are based on analysis of a range of factors and information using a process we call 'Focus on Change'. None of these factors has a pre-defined weight in the investment process, nor does our ESG analysis. So no, we can't quantify the weight that ESG data plays. It is simply part of the mix of information that fund managers consider when making investment decisions.

There is an expectation by some people that you can pull apart every influence on an investment decision and identify the weight played by each factor, but that is not only very difficult to do, it's not always worthwhile. People should look at the whole picture. Our skill as an active fund manager is in looking at the whole picture and making decisions that produce the investment objectives set out by our clients.

PRI: Can you give me an example of how your team actually turns ESG analysis into useful investment information?

Yes. For example, we recently looked at an industrial goods company that identified the retention and recruitment of skilled employees as a key risk for its business in its annual report and accounts.

However, the company did not disclose in its reporting how it intended to address this risk. We arranged a meeting with the company and asked what strategy it had adopted to manage this issue. We learned that that the company had not actually taken any action to support the retention of key staff or the recruitment needs for additional experienced professionals. We discussed this with our fund managers, who noted that on other important issues the company lacked adequate central controls over a disparate business structure. The lack of central controls and adequate risk management resulted in a negative view of the company's prospects and led us to underweight the stock.

Similarly there have been cases where our positive assessment of how a company manages environmental or social issues has contributed to our confidence in being overweight a stock.

PRI: So what are your team's internal processes for selecting and analysing environmental and social issues?

Our responsible investment team follows the same approach that our fund managers do, which is looking companies by sector and benchmarking them against their sector peers on the management of environmental and social issues.

We get our information from several sources which include:

- Company reports

- Our own private meetings with companies
- Regulatory reports
- Broker research

We do our own original research rather than buying in analysis from a third party research provider.

The length of time for producing assessments of companies really varies, depending on sector and company. At most it will take a few days.

PRI: Who selects the environmental and social issues that you look at?

They can come from within my team or from the fund managers. Some are quite obvious and companies are getting much more astute in identifying the key environmental and social risks for their business. Increasingly, we are seeing companies themselves raise these issues when they come in to speak to our fund managers.

PRI: What advice might you offer to other signatories who work in responsible investment teams and might be struggling to convince their fund managers of the importance of ESG issues?

They should try and follow the investment analysis style used by their fund managers. See what the fund managers think are the key drivers for the sector or for the company in question, and then work out how ESG issues can impact company performance in that framework.

They can also emphasise how the management of ESG issues reflects on the general quality of management and the adequacy of controls.

PRI: Would you suggest framing these issues in more of a risk or an opportunity prism?

I think it is definitely both. It depends on the sector and the company.

For example, on the opportunity side of things we might look at how food retailers are enhancing their range of products to appeal to consumers with products which are organic, chemical-free, or have been produced with fair treatment of animals. On the risk side we would look at how a company in a sector with high fatality rates, such as mining, is taking steps to ensure a safe workplace.

PRI: How do you report?

We tailor our reporting to meets the needs of each client. Some clients have asked for, and receive, reports on our engagement activities. Clients generally get a report on our voting activity. We also publish our voting record on our website.

PRI: What do you feel are the implications of the financial crisis for your work, and what are some of the other challenges facing responsible investors?

The dust hasn't settled yet on the crisis. But one big issue is going to be executive remuneration. There is certainly a heightened interest in remuneration and we will be looking very carefully at pay and bonus awards. Responsible investors will not tolerate irresponsible pay policies.

The challenge of ensuring ESG remains a part of the overall mix on investment decisions remains a large one. We must continue to strive for quality in our research and evaluations.

Also, when it comes to disclosure of ESG information from companies it is not a perfect world. When we review reports from companies we seek to make constructive comments to companies about what additional information would be helpful.

PRI: Do you get involved in asset classes other than equities?

My team also feeds information through in the property and bond asset classes. Also don't forget that corporate debt issuers and listed property companies are some of the listed equity companies we cover in our equities work so there is some cross-over.

PRI: The Standard Life group is very big and very diverse. How does your team manage in such a large organisation?

As mentioned, our company Chairman also chairs a board committee on corporate responsibility. The board exercises oversight over all aspects of corporate responsibility in the group and this is a driver for a coordinated and consistent approach. The constitution and terms of reference for this group are online.

We also have an Executive Corporate Responsibility Committee that meets at least four times a year to co-ordinate activity across the group. This committee includes representatives from every operating business within the Standard Life group and I represent Standard Life Investments. This Committee really can monitor and report on issues and ensure everyone is joined up.

In practical terms, each representative from across the group will bring their own points of discussion, and our Head of Corporate Responsibility organises the agenda and takes things forward.

PRI: How important to an organisation do you think it is to have a Head of SRI?

Well I can't speak for other organisations but in our case it has worked very well.

I've been in post since 2001 and the responsible investment environment has changed a lot since then. Most notably there are a lot more pension funds interested in ESG issues, especially public pension funds from around the world.

PRI: What do you think has driven that change?

A whole range of things. Interest from the beneficiaries of these pension funds, a desire by the funds themselves to stay on top of emerging trends, and a similar desire from investment managers. Also the awareness from investment managers that they need to make sure their products and processes reflect the needs of their clients.