

INTERVIEW

Up to trustees to make system work

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Those responsible for funds are failing in their duties to act as owners of the companies they invest in, according to Robert Monks. **David White** reports



Monks: 'an ugly little secret that everyone pretends doesn't exist'

Pension funds, as quintessential long term investors, can be a world force for corporate governance reform. This is the long-held creed of Robert Monks, one of the founding fathers of corporate activism in the US and the UK.

For two decades, Monks has argued that investors should take a more active interest in the behaviour of the companies they invest in. In the 1990s, when a bull market disguised the shortcomings of companies, few heeded his message. However, as the longest running bear market for 40 years unwinds, the tide is turning in Monks' favour.

In the UK, corporate activism, which has smouldered for the past few years, has suddenly burst into flames. In the past few weeks, concerted opposition by institutional investors has led to the removal of the chairman of Cable & Wireless and forced GlaxoSmithKline to reverse its decision to double the salary of chief executive Jean-Pierre Garnier.

Monks is sceptical about the British approach to corporate activism, which he describes as "principles with fine sounding words and deals done behind closed doors". He is not optimistic that the Institutional Shareholders Committee established recently by, among others, the National Association of Pension Funds, will achieve much.

He prefers the more robust approach adopted in the US, where a few large public pension funds have taken on the corporations and won. Monks himself has advised the trustees of California Public Employees Retirement System (Calpers), one of the country's most influential institutional investors. Under his tutelage, Calpers has opposed anti-takeover devices such as poison pills and objected to excessive pay for chief executive officers.

Monks has also made more than a little money out of corporate activism. In 1985 he and his business partner Nell Minow set up Institutional Shareholder Services (ISS), a shareholder advisory company that provides individual and institutional investors with proxy

advice. And in 1991 he and Minow set up the Lens investment fund to take shares in underperforming firms and campaign for board changes. During its 10-year life, Lens has narrowly outperformed the S&P 500 and earned its founders \$30m (€30m).

Unsurprisingly, Monks is an admirer of Warren Buffett, an investor who has shown that active shareholder involvement in the governance of the companies can produce good returns. Like Buffett, he says he wants to create "a culture of ownership responsibility".

But who are the owners of a company? The obvious answer is the shareholders. However, Monks says this definition does not take us very far. "A shareholder may be someone who owns an index fund. They have made no commitment to the company. They're committed to an index not to a company."

He prefers to focus on pension funds and their members. He points out that over the past 10 years pension funds have become the largest holders of equity securities across the world. One estimate suggests that, of the world's €7trn in equities, €4trn is held by pension funds. "Pension funds no longer influence the market. They are the market," says Monks.

More controversially, he argues that pension fund members are the real but unacknowledged owners of companies. "As the beneficiaries of final salary (defined benefit) schemes, pension fund participants are the owners of the companies in which their scheme invests. So I think it's critical to say once and for all that the defined benefit plan pensioner is the shareholder."

Monks likes to cite Peter Drucker's book 'Pension Fund Socialism', published in 1976. "Drucker said that Karl Marx would be thrilled if he woke up in 1976 and found out that workers own the corporations."

However, Monks is not asking the new owners of corporations to make day to day business decisions, since they do not have expertise. Nor is he asking them to intervene in the management of companies other than in real emergencies. Most of a pension funds' holdings are likely to perform reasonably well, so the only involvement needed by the shareholders will be an intelligent voting of the proxy.

Although the powers of the new owners are limited, they are important. Yet they are being denied, says Monks. "Pension plan members in the US are unable to exercise their powers of ownership because the trustees who manage their plans are usually picked by management, and have traditionally supported management without question."

Furthermore, the plan's trustees and managers do not have to reveal how they voted their proxies. So the plan beneficiaries are unable to find out whether the trustees have acted in their interest.

Yet trustees are legally obliged to act in the plan beneficiaries' interest, says Monks. "The law is very clear. The law requires that the trustee should act exclusively for the benefit of the plan's participants in the pension scheme. So the legal obligation to act for the beneficiary and if necessary against their business interests is very plain. Unhappily the law is not enforced."

One reason why the law is not being enforced is that there is a conflict between the fiduciary duties and commercial interests, he suggests. The investment banks that manage the funds of pension plans are wearing too many hats. Being both commercial banker and pension fund manager puts the investment bank into an inherent conflict of interest. "Investment banks will not intervene in the affairs of a company for who they may be doing other work. It's an ugly little secret that everybody pretends doesn't exist," he says.

Another reason for non-enforcement is the feeling that Monks, and people like him, are rocking the boat. "Deep down most trustees just wish I'd go away, because they say things are fine, so why change them. But they are not doing their job. There's a real need for enforcement. The law is there—the 'solemn law of trust'—but it is not being enforced. Trustees need to be reminded of their legal obligations."

Monks know this can be an uphill task. In the 1980s he was assistant secretary of labor in the Reagan Administration, with responsibility for regulating pension funds under the Employee Retirement Income Security Act (ERISA). One of his achievements was to define the obligations of pension fund trustees to vote the stock in portfolio companies and to act like owners of those companies. "The obligation was implicit in the law, but nobody was doing it. So I made it explicit. But since I quit they've never enforced that either."

He has little patience with the argument that trustees are amateurs and therefore unable to make decisions about the conduct of the companies they invest in. "Trustees may say they're not particularly well qualified to do it. This excuse is not worthy of serious consideration. Why should you allow someone to accept the compensation for being a trustee and then allow them to say they simply choose not to exercise the obligations of being a trustee?"

Monks suggests that such dereliction of duty amounts to misrepresentation, even fraud. "They are advertising trust law to pensioners—what one jurist called the morals above the morals of the market place. Yet because of the trustees' failure to enforce trust responsibly the plan participants are being defrauded. They are not getting the protection that has been advertised."

This protection should embrace some concept of the 'greater good' Monks believes. He says that trustees should have a fiduciary duty to press for programmes of sustainability, socially responsible investment and corporate social responsibility in the companies where they hold shares. "The pension plan participant wants to retire in 18 years' time with enough money and in a clean, civil world. You probably shouldn't be more precise than that. But what is critical is that the trustees take a longer term view."

Understandably, most members of pension funds feel powerless to intervene at this level. Yet Monks says that they should have the legal right to make their views known. "Inertia only exists because participants who have complaints have no way of articulating these complaints. The alternative is to create some kind of legal rights in the plan that allows participants to initiate un-ignorable proceedings at an affordable cost."

The collapse of US power giant Enron was the clearest signal that something must be done. It is time, he says, that pension funds begin to act like real owners of companies and check more carefully the behaviour of their boards and management. "Following Enron, there can be no delusion that the present system works. We can now turn to something that will."

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