



International Centre for
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“Identifying and Mobilizing Win-Win Opportunities for Collaboration between Pension Fund Institutions and their Agents”

Dr. Danyelle Guyatt
Visiting Fellow, University of Bath

For Further Information:

Rotman International Centre for Pension Management

151 Bloor Street West, Suite 702

Toronto ON M5S 1S4 CANADA

Tel: 416.925.7525

Fax: 416.925.7377

icpm@rotman.utoronto.ca

www.rotman.utoronto.ca/icpm

Table of contents

Part I: Key conclusions and recommendations.....	2
Overview.....	3
Key conclusions.....	4
Key recommendations.....	7
Part II: Review of existing collaboration initiatives and case studies.....	10
Improving the pension fund management process.....	11
Voluntary, agent-based solutions.....	12
Collaboration defined.....	15
Overview of existing collaborative initiatives.....	17
Case studies of collaborative initiatives.....	19
Case Study 1: The Carbon Disclosure Project.....	21
Case Study 2: The Council of Institutional Investors.....	27
Case Study 3: The Enhanced Analytics Initiative.....	35
Addendum to Case Study 3: Collaboration between the EAI and the UN PRI.....	42
Towards building a collaborative framework.....	45
Part III: Theoretical framework for identifying ‘win-win’ collaborative opportunities	46
Introduction.....	47
The meaning of ‘win-win’ in a collaborative setting.....	47
The contribution and limits of game theory.....	52
The free-rider hurdle.....	55
Evolutionary game theory and adaptive efficiency.....	59
Evolution of cooperation.....	60
Evolution of conventions.....	62
A collaborative framework for changing conventions.....	64
Application of the collaborative framework.....	67
Where to from here.....	78
Part IV: Recommendations for the Rotman ICPM and its Partners	80
Scope and potential influence.....	81
Lengthen the investment horizon.....	82
Promote increased shareholder activism.....	83
Promote better pension fund governance.....	85
Conclusion.....	87
Bibliography.....	88
Appendix 1: Corporate governance initiatives.....	94
Appendix 2: Small group institutional investor initiatives.....	97
Appendix 3: Industry body, semi-government and NGO initiatives.....	99
Appendix 4: Climate change initiatives.....	102
Appendix 5: Responsible investment initiatives.....	105
Appendix 6: Academic/education initiatives.....	108

Part I: Key conclusions and recommendations

Overview

This report is about identifying and mobilising ‘win-win’ opportunities for collaboration to improve the pension fund management process. The research purpose, process and methodology are outlined below.

Research purpose, process and methodology

Research purpose: Identifying and mobilising ‘win-win’ opportunities for collaboration to improve the pension fund management process	
Steps in Research Process:	Methods:
1. Study what collaborative initiatives exist and their positive and negative features ↓	Review over 30 collaborative initiatives Qualitative case study analysis on 3 initiatives to examine: – Factual information (objectives and characteristics) – Evaluation (positive and negative features)
2. Theory Generation ↓	Evolutionary Game Theory Cooperation Theory Conventions Theory
3. Development of Framework ↓	8 step framework for the identification and mobilisation of collaborative opportunities
4. Application of Framework ↓	Application of the collaborative framework to the challenges: 1) Short-termism 2) Absence of shareholder activism 3) Poor pension fund governance
5. Quantitative Research ↓	Questionnaire on Priorities for Collaboration – Statistical significance – Hypothesis testing
6. Recommendations and Feedback	Presentation and discussion at June 2007 Rotman ICPM workshop

The outline of this report is as follows: Part I presents a summary of the key conclusions and recommendations contained within this report. Part II presents a review of over 30 existing collaborative initiatives and 3 case studies to examine the positive and negative features of these. Part III develops a theoretical framework for identifying win-win collaborative opportunities and applies this framework to examine the challenges of short-termism, the absence of shareholder activism and poor pension fund governance practices. Part IV presents some recommendations for the consideration of the Rotman ICPM and its Partners. The results of a questionnaire on identifying the priorities for collaboration will be presented for discussion at the Rotman ICPM workshop in June 2007.

Key conclusions

Collaboration has emerged as a popular and often highly-praised way to promote change in industry-wide practices across the investment community. The focus of this study is on identifying the potential role of collaboration amongst pension funds and their agents to address the problems of short-termism, absence of shareholder activism and poor pension fund governance. As part of this study, over 30 collaborative initiatives have been reviewed, with case-studies carried out on the Carbon Disclosure Project, the Council of Institutional Investors and the Enhanced Analytics Initiative. The main findings and conclusions of the study are summarised below:

- Collaboration to promote industry-level change can be more efficient than acting individually owing to the economies of scale benefits of pooling resources, sharing costs, sharing knowledge and power/influence. It also has the benefit of sharing the risks associated with introducing change and innovation (Page 14).
- By engaging industry participants in the change process, collaboration can mobilise ‘intrinsic motivation’ in a way that externally imposed rules/laws cannot. This is not to suggest that there is no role for government regulation or guidelines, but rather that the investment agents themselves could potentially be the architects of any new paradigm and ultimately share the responsibility for its success and/or failure (Pages 12-14).
- The case study on the Carbon Disclosure Project praises the initiative for its low cost, straightforward approach to improving disclosure of carbon emissions amongst corporations. However, there is little evidence to suggest that institutional investors have integrated the carbon emissions data into their investment analysis. The absence of any imperative to change the behaviour of signatories increases the risk that collaboration becomes a box-ticking exercise (Pages 21-26).
- The case study on the Council of Institutional Investors highlights the value of having clear goals and objectives and legitimacy amongst market agents. The empirical evidence suggests that the CII has produced a net benefit in terms of the ‘focus list’ performance of target companies. Nevertheless, an increased focus on international governance standards

would help to bolster the CII's efforts, including collaboration between the CII and other international corporate governance networks (Pages 27-34).

- The case study on the Enhanced Analytics Initiative praises the initiative for its unique approach in mobilising the contractual relationships that exist between market agents; in this case, its goal to encourage brokerage firms to bolster analysts' research on extra-financial indicators. On the downside, a potential selection bias with a small sample of analysts chosen for review, the early announcement of plans to disband by 2010 and the small allocation of brokerage fees (limited to 5%) could undermine its effectiveness (Pages 35-42).
- Despite the potential benefits of collaboration, the case study evidence revealed that it is not a panacea. For collaboration amongst investment agents to succeed over the long-term, the participating agents must genuinely believe that meeting the goals of the initiative will be beneficial for themselves and/or their representative institution. If this basic condition is not satisfied then collaboration for collaboration's sake could be a costly and wasteful exercise (Page 48).
- A theoretical framework is developed that draws from evolutionary game theory, cooperation theory and conventions theory (Pages 59-63).
 - Evolutionary game theory advocates the importance of adaptive efficiency and the recognition that agents need not be locked into a Pareto-inferior mode of behaviour indefinitely (Samuelson, 2002). Collaboration amongst pension funds and their agents could be indicative of adaptive efficiency.
 - The theory of cooperation expounds the importance of reciprocity, trust and to enlarge the 'shadow of the future' of any cooperative arrangement (Axelrod, 1984). In other words, that all agents mutually benefit from the arrangement and, for it to be sustained over time, a high level of importance needs to be attached to future interactions to provide a disincentive to defect.
 - On the theory of conventions, collective agreement is one way in which new conventions can emerge when a group recognises the superiority of alternative

conventions and deliberately sets about encouraging a change in behaviour (Boyer and Orlean, 1992).

- Individuals are inherently self-interested and that is the core motivation behind any desire to collaborate with others. However, a wider interpretation of self-interest is required that challenges the narrow definition of rationality and takes into account how individuals decide what is, or is not, in their self-interest. Whilst the pursuit of self-interest is the ultimate (fixed) goal in deciding whether or not to collaborate, the determinants of self-interest are time varying and dependent on an agent's beliefs, priorities and perception of legitimacy surrounding the collaborative initiative (Pages 50 and 65).
- Drawing from the literature and case study evidence, an 8-step collaborative framework has been developed that specifies the nature of the problem; the conventions that underpin the problem; identifies the target agents for change; where the power relations lie between interacting agents; assesses if there are sufficient motives for collaboration and trust between power agents; the design of the initiative; implementation; and its ongoing evaluation. As new practices and conventions emerge, they will eventually become integrated into daily decision making. This, in turn, reduces the need for explicit collaboration and the costs incurred from such activities will diminish (Pages 64-66).
- The application of the collaborative framework to the problems of short-termism, absence of shareholder activism and poor pension fund governance produced a total of 14 conventions that contribute to these problems. The role and influence of different power agents over the target agents for change are examined, alongside an evaluation of whether existing collaborative initiatives tackle these issues. On balance, this analysis revealed that there is significant untapped potential for collaboration to redress some of the problems with investment agent behaviour via direct contractual and/or indirect relations between power agents and target agents for change (Pages 67-79).

Key recommendations

Participation in the Rotman ICPM activities is a form of collaboration in itself and, as such, the key recommendations suggest actions that each partner could take both individually, collaboratively (in conjunction with ICPM) or through cooperation between ICPM and other agents along the investment management chain. The key recommendations are summarised below.

- Work towards lengthening the investment horizon (Page 82):
 - Widen the valuation metrics and reduce excessive focus on near-term company earnings through: reviewing incentive systems for fund managers; encouraging consultants to alter their criteria for assessing fund managers; and joining the EAI.
 - Shift the focus from measuring and reviewing relative returns against asset-based benchmarks to liability benchmarks through: encouraging all agents to review existing benchmarks; fostering new research and education on alternative benchmarks; and collaborating with specialist research groups on the construction and management of liability benchmark portfolios.
 - Lengthen the performance appraisal horizon and the average length of investment mandate contracts through: communicating with investment agents the perils of high portfolio turnover; lengthening the average term of investment mandates; developing and disseminating best practice standards; and educating investment agents on the risks of short-term performance assessments.
- Promote increased shareholder activism (Page 83):
 - Better specify board-level policy on shareholder activism through: communicating and disseminating evidence-based arguments to trustee boards; asking consultants to reflect shareholder policy in mandate design, fund manager selection and review processes; developing and disseminating

best practice standards; and liaising with government regulators about mandatory disclosure of a shareholder activism policy.

- Support better training and expertise of shareholder activism practices through: lobbying education groups and industry bodies to review and integrate shareholder activism into accreditation and training; introducing and lobbying industry regulators for mandatory training standards; and developing best practice standards for implementation of a shareholder activism policy.
 - Encourage stronger participation and disclosure of voting and engagement activities through: joining a regional collaborative initiative; liaising with industry representatives to develop uniform, international standards for minimum disclosure; lobbying for mandatory disclosure and reporting of voting and engagement activities; supporting research and building best practice case study examples.
 - Increase importance of shareholder activism in fund manager selection and performance review through: asking consultants to integrate shareholder activism into the rating, selection and review of fund managers; encouraging rating agencies and financial advisors to build shareholder activism criteria into their processes; and collaborating with educators to better inform beneficiaries and their advisors on voting and engagement activities.
- Promote better pension fund governance (Page 85):
 - Improve accountability and transparency of board appointments through: reviewing existing policy of trustee/governing board appointment procedures; lobbying regulators to introduce higher standards and transparency; and working to create international standards of accountability in trustee appointments in collaboration with industry groups.
 - Reduce over-reliance on for-profit external agent advice through: reviewing pension fund governance policy and utilising internal expertise; developing a not-for-profit ‘pension fund governance’ collaborative initiative in conjunction with other academics, trustees, pension fund executives,

regulators, industry bodies and international organisations; and supporting and disseminating research on best practice standards.

- Improve investment knowledge of board members through: developing and disseminating board member selection criteria that stipulate a minimum level of investment knowledge and competency; and introducing and lobbying industry regulators via the ‘pension fund governance’ initiative for mandatory training of existing board members.
- Improve balance sheet risk management practices through: encouraging the board of trustees to unify the management of assets and liabilities (or where this has already been implemented, share with others as to the techniques and processes); asking actuaries to value liabilities over regular intervals based on different assumptions and current yields; asking consultants and actuaries to consider how investment mandates can be better defined to align with pension plan liabilities (where this has already been implemented, share experiences with others); and collaborating with regulators via the ‘pension fund governance’ initiative to find solutions to prevent balance sheet management issues from inappropriately interfering with investment policy.
- In light of the recommendations above, discuss and agree on the priority areas for collaboration that tackle some of the identified conventions associated with short-termism, the absence of shareholder activism and poor pension fund governance. A questionnaire has been disseminated to assist in these deliberations, the results of which will be presented and discussed at the Rotman ICPM Workshop in June 2007.

Part II: Review of existing collaboration initiatives and case studies

Improving the pension fund management process

This report is about identifying and mobilising ‘win-win’ opportunities for collaboration to improve the pension fund management process. The following challenges have emerged in the course of Rotman ICPM’s research and workshop activities in regard to the way in which pension fund assets are invested:

1. Short-term investment horizon
2. Absence of shareholder activism
3. Poor pension fund governance practices

Short-termism is most commonly referred to as myopic behaviour and the resulting tendency to over-emphasise the present (near term cash flows) at the expense of longer horizons (Frederick et al., 2002). Case study evidence of short-termism amongst UK fund managers (Guyatt, 2005) is supported by empirical evidence at the aggregate level¹. Short-termism was identified as a problem with the institutional investment management process in the Myners Review (2001) and featured as an issue at the Rotman ICPM workshop in June 2006 and a series of CFA-led roundtable discussions and a subsequent report released in July 2006 entitled “Breaking the Short-Term Cycle”.

The absence of shareholder activism amongst pension funds and other institutional investors emerged as a recurring theme at the Rotman ICPM workshop in June 2006. Bogle (2005), Monks and Sykes (2006) and Davis et al (2006) observed the apparent conflict of interest that limits the extent to which fund management firms behave as active shareholders. Indeed, the incentives for private fund management firms (including mutual funds, corporate pension funds and for-profit fund management firms) to exercise power over investee companies via voting and/or engagement practices can be undermined by commercial pressures for a number of reasons. First, activism generates an upfront cost (in terms of time and effort expended) with uncertain future benefits. Second, there is a fear that activism could damage an investment firm’s reputation if they are seen as trouble-makers in the corporate world, thereby jeopardising future

¹ For example, Black and Fraser, 2000 found evidence of short-termism across international markets, whilst Nickell and Wadhvani, 1987; Miles, 1993; and Cuthbertson et al, 1997 found some evidence of its existence in the UK.

dealings across other parts of their business offerings (Bogle, 2005:84). This has encouraged some agents to ‘free ride’ on the shareholder activism efforts of others.

Poor pension fund governance is another issue that has emerged during the course of the Rotman ICPM’s research and workshop activities. Ambachtsheer (2007:11-13) listed some of the failings of current pension fund governance practices to include ill-defined risk exposure for stakeholder groups, irregular monitoring of balance-sheet risk exposure, lack of skill and expertise of trustees, lack of transparency in trustee appointments, misunderstanding of the board of trustee’s role and the interference of accounting and balance sheet management with investment policy. Davis et al (2006) also emphasised the shortcomings with the governance process, highlighting a study that found trustees in the UK spend fewer than four hours a year dealing with investment matters in board meetings, with only 25% of funds requesting that trustees undertake training and little evidence to suggest that trustees ever challenge investment consultants or monitor their performance².

Voluntary, agent-based solutions

At the heart of seeking collaborative solutions to improve the pension fund management process is a belief that market agents themselves could play a key role in implementing long-term change by recognising and utilising the interdependencies that exist in terms of market structure, decision making processes and agent behaviour (Schmid, 2004). This is not to suggest that there is no role for government regulation, but rather that the investment agents themselves could potentially be the primary architects of any new paradigm and ultimately share the responsibility for its success and/or failure.

Economic theory and regulation

Economic theory posits that government regulation is required where there is some form of market failure that is detrimental to society as a whole, the classic examples being: firstly, if the good/service is a public good that the market may not necessarily provide (such as the provision of healthcare and education); if there is a natural monopoly and the producer has excessive market power to the detriment of society; and/or the protection of public interest from negative

² These observations were based on the findings of a Department of Work and Pensions report on trustee boards in the UK, as cited in Davis et al (2006:78).

externalities associated with the production or consumption of a particular good or service (e.g. health risks from smoking). Arguably, a short-termist ‘renting’ mentality amongst pension fund agents falls under the latter category; that is, there is a negative externality associated with such behaviour and therefore there is a possible role for government to protect the interests of the various stakeholders who might be adversely affected.

In the search for solutions to the identified investment problems, the limitations of regulation in producing the ‘right’ type of behaviour amongst investment agents need to be taken into account. As Gully and Muchie (2003) argued, it is not the case that good laws invariably make good conduct. In a dynamic and global investment environment, it is particularly difficult for regulators to legislate to control investor behaviour on issues that might be subjective, such as the extent to which they should lengthen the investment horizon and engage in shareholder activism. Regulators would need to have considerable investment knowledge and resources to develop the appropriate laws and rules and to implement and regulate their ongoing compliance; time and effort that may prove to be fruitless, lagging investment practices and perhaps be better spent elsewhere.

The importance of intrinsic motivation

It will therefore be argued that values and principles that are internalised within the investment community are more likely to be effective in changing behaviour than those externally imposed. Such arguments form the basis of the model of ‘governance without government’ of Rosenau (1992), drawing from Luhmann’s systems theory and Rawl’s theory of justice. The ‘governance without government’ model builds on the notion that ‘self governing’ principles require an acceptance and integration of values and responsibility into day-to-day life, rather than these being imposed artificially. The philosopher Hobbes also suggested that the desire for self-preservation gives people a reason to seek cooperative solutions to social dilemmas.

Extending this line of inquiry to the investment management community, if change comes from within then there may be more ‘buy in’ to the process and it could become a more pervasive influence on their day-to-day decision making and behaviour. On its own, enforced change to the investment management process through legislation could not only create inefficiencies but it could also undermine the motivation of the investment agents to foster real change.

The absence of universalities

The moral pluralist argument suggests that because we live in an increasingly complex and dynamic society, we should embrace and respect local customs and values and not assume that universalities exist or can be found at the international level. The absence of universalities makes it difficult – if not impossible – for international laws to externally impose standardised investment management practices without conflicting with an investment institution’s specific goals and objectives. This is not to say that we should not attempt to guide behaviour through setting principles and standards, but that flexibility in terms of design and implementation is needed to reflect the heterogeneous nature of investment agents. Indeed, this is the philosophy underpinning some of the collaborative initiatives that will be reviewed in this paper, such as the UN Principles for Responsible Investment and the Enhanced Analytics Initiative. When collaborative initiatives of this kind are led by, and for, the institutional investment management community they are not only likely to be steered by better-informed architects of a new paradigm, but agents also have a responsibility and therefore a self-interested motivation to maximise the potential for its success.

Collaboration to produce industry-level change

The potential power and influence of well-designed collaborative efforts that focus on solving market problems and improving industry-wide practices should not be underestimated. First, there are economies of scale advantages that make collaboration between interacting agents a more cost effective and efficient way to implement change through pooling resources and sharing knowledge. Second, there are benefits in terms of sharing the risks associated with introducing change and new innovations, or what market agents refer to as the ‘first mover risks’ (Hoffman et al, 1999). This is particularly true when the innovations are directed towards industry-level change where there are perceived risks of being different from the crowd that may encourage some coordinated level of effort (Keynes, 1936). Third, in many situations coordinated efforts will be a more powerful and effective means of driving change and improvements than individual actions. Not only would a group of market agents have more power in terms of dollar value and representation at the industry level, but they would also be perceived as a legitimate voice that carries more weight in influencing the behaviour of others than could be achieved individually.

Collaboration defined

The first point of note is the different terminology that is often used to describe the concept of ‘collaboration’. A large scale review of literature on collaboration carried out by Mattessich and Monsey (1992:43) revealed that three main terms are most commonly referred to:

1. Cooperation. Usually between individuals where the relationship tends to be informal and the interaction is on an ‘as needed’ basis. This is the phrase most commonly used in game theory literature in the study of interaction between market agents (Axelrod, 1984) [Borrowing from the market efficiency terminology, this might be described as ‘weak form’ collaboration].
2. Coordination. Where interaction is usually focussed on a specific task with a pre-defined length and focus and individual relationships are supported by the organisations that they represent. There is some degree of sharing in the resources and rewards, although these are limited to the specific project goals for a specified period of time [‘Semi-strong form’ collaboration].
3. Collaboration. Represents a broader commitment between high level agents within organisations who share common strategic industry-level goals, where a long-term partnership is considered desirable. It can involve a relatively high degree of commitment in terms of sharing the risks and rewards from the initiatives’ failure or success [‘Strong form’ collaboration].

For the purposes of this paper, the following definition will be used:

Collaboration prevails when a mutually beneficial relationship exists between two or more participating agents, recognising that this relationship can be informal (cooperation), task specific (coordination) or representative of a long-term partnership with shared goals and objectives (collaboration).

The set of individuals and/or institutions that join together in collaboration will be referred to as a collaborative group.

The individuals that represent collaborative institutions will be referred to as partners.

As noted by Ansari et al (2001) collaborative initiatives are more often than not aimed at achieving some sort of change or adoption of new behaviour. Prochaska and DiClemente (1986) outlined the stages of change in behaviour over time, as illustrated in Figure 1. The stages begin

with *pre-contemplation* to *contemplation*, where the intention of the change is present, albeit not in the immediate future. The *preparation* stage then follows, where the individuals intend to make a change in the immediate future and make small preparatory changes. Then the *action* stage, where attempts at change are active, and finally the *maintenance* stage where the change is adopted and continued, with active or conscious effort required for it to be sustained.

Figure 1: Stages of change in behaviour

Stage	Description
1. Pre-contemplation	No intention of changing behaviour
2. Contemplation	Intention of changing behaviour develops
3. Preparation	Changes planned for the immediate future
4. Action	Implementation of change
5. Maintenance	Change is adopted and assessed

Source: Adapted from Prochaska and DiClemente (1986)

Applying this framework to Rotman ICPM and its Partners, the group is currently in the *preparation* phase of its collaborative efforts, focusing on defining and developing possible collaborative opportunities for improving the functioning of the pension fund mechanism. The subsequent stages would involve the design and implementation of collaboration, followed by the maintenance and measurement of its effectiveness over the medium to long-term. As Whipple and Frankel (2000:22) argued, partnerships or alliances are formed with an end goal or performance objective in mind, thus making it imperative that the impact of any collaborative effort is measurable in order to gauge its success:

“...firms recognize that a cooperative relationship is not a sufficient condition for a successful alliance. Performance must be enhanced and specific goals must be achieved in order for the firm to acknowledge that the transition to an alliance is worthwhile. As such, alliance success is not solely determined by interpersonal attributes, but must also include enhanced performance. Therefore, “win-win” has both a “soft” people-oriented focus as well as the need for “hard” performance-oriented improvements. In this sense, performance and “people skills” interact to determine the viability and success of an alliance.”

Building on this observation, any new or existing collaborative initiative should have some measurable element of success against specific goals to assess improvements in agent behaviour (against qualitative criteria) and pension fund efficiency and performance (quantitative criteria). Over time, as and when an initiative moves closer to attaining its goals, the process of collaboration can be unwound as the new practices become built in to day-to-day activities.

Overview of existing collaborative initiatives

This section reviews some of the existing collaborative networks amongst institutional investors, categorising these on the basis of their core goal and function. The first observation to make is that there are a large number of collaborative arrangements that already exist, with an increasing number of researchers and market participants applauding the merit of collaboration as a means of promoting change and improvement to the pension fund management process (Ambachtsheer, 2007; Arnott, 2006; Davis et al, 2006; and the Marathon Club, 2005).

Over thirty networks have been studied³, falling under the categories of: 1) corporate governance; 2) small group institutional investor groups; 3) industry bodies, semi-government and NGO groups; 4) climate change groups; 5) responsible investment groups; and 6) academic/education initiatives. A content analysis of their websites and publicly available information was carried out to analyse their characteristics including the country/region focus, core objectives/functions, member profile and the extent to which they represent cooperation, coordination or collaboration. The output of this analysis is presented in Appendices 1 – 6.

Corporate governance initiatives (Appendix 1)

1. Council of Institutional Investors (CII)
2. International Corporate Governance Network (ICGN)
3. Canadian Coalition for Good Governance (CCGG)
4. Asian Corporate Governance Association (ACGA)
5. European Corporate Governance Institute (ECGI)
6. Global Corporate Governance Forum (GCGF)

Small group institutional investor initiatives (Appendix 2)

7. Marathon Club
8. Enhanced Analytics Initiative (EAI)
9. CalPERS and Hermes
10. Investment Protection Principles (IPP)

³ The list of collaborative groups reviewed in this report is by no means a complete summary of all initiatives that relate to the institutional investment community; rather it is intended to provide a cross-section of some major collaborative initiatives across different types and functions.

Industry body, semi-government and NGO initiatives (Appendix 3)

11. Investment Company Institute (ICI)
12. National Association of Pension Funds (NAPF)
13. Association of Canadian Pension Management (ACPM)
14. European Fund and Asset Management Association (EFAMA)
15. Association of Superannuation Funds Australia (ASFA)
16. CFA Institute

Climate change initiatives (Appendix 4)

17. Carbon Disclosure Project (CDP)
18. Ceres
19. Investor Network on Climate Risk (INCR)
20. Institutional Investors Group on Climate Change (IIGCC)
21. Investors Group on Climate Change (IGCC)

Responsible investment initiatives (Appendix 5)

22. UN Principles for Responsible Investment (UN PRI)
23. UK Social Investment Forum (UKSIF)
24. European Social Investment Forum (Eurosif)
25. Social Investment Organisation (SIO)
26. Social Investment Forum (SIF)

Academic/education initiatives (Appendix 6)

27. Rotman International Centre for Pension Management (ICPM)
28. Pension Research Council (PRC)
29. Pensions Institute
30. CFA Centre for Financial Market Integrity
31. The Shareholder Association for Research and Education (SHARE)
32. Netspar

A few general observations to make about the collaborative initiatives reviewed in this paper:

1. Most initiatives have a narrow focus in terms of the region/country coverage (very few are global), although there is an increasing trend for networks to form sub-alliances under

regional umbrellas and cross-collaborative initiatives (e.g. Ceres, Eurosif, UN PRI and EAI);

2. Many initiatives are ‘cause-based’ meaning that they are focused on the pursuit of specific goals such as the promotion of good corporate governance (CG), corporate responsibility (CR) and climate change;
3. There are less general initiatives focused on improving the pension fund management process, although more are emerging such as Rotman ICPM, the Marathon Club (long-term horizon) and the Enhanced Analytics Initiative (broker research); and
4. Pension fund educators are rising in significance and importance – the PRC and Netspar are the closest initiatives to Rotman ICPM in terms of their mandate and management structure (with institutional investors as partners). Collaboration between the educators has also developed as Rotman ICPM and Netspar plan to co-host a colloquium on 30-31 October 2007 together with the University of Maastricht.

Case studies of collaborative initiatives

Further analysis was carried out on three of the identified collaborative networks to evaluate their objectives, characteristics and positive and negative features to assess what works, what doesn’t and the lessons for Rotman ICPM in its deliberation on collaborative solutions to the identified investment problems.

Criteria for selection

Criteria 1: Cross-section of collaboration across categories. The three case studies were selected on the basis of their representation across different category types, including climate change, CG and small group initiatives. It was considered important to provide some variation in terms of the focus of the collaboration initiatives to ensure that the assessment was based on their key features and characteristics, rather than on the merit of the ‘cause’ that each initiative pursues.

Criteria 2: Led by institutional investors. The second criterion was to focus on initiatives that had been established, or led by, institutional investors and their agents. Coalitions that are predominantly led by the change agents themselves will have different characteristics and drivers than those led by ‘outsiders’ to the investment process.

Criteria 3: Cross section of international and domestic representation. Some of the collaborative initiatives are focussed on producing change to domestic agent behaviour and are mainly comprised of domestic market participants. Such coalitions face different challenges to those that are comprised of multi-nation agents with an international focus. Consequently, in assessing the positive and negative features of collaborative structures, there may be important lessons to learn from initiatives that have both an international and domestic focus to their efforts. The case studies were selected with this aim in mind.

Criteria 4: Emphasis on producing investment industry change. Finally, some coalitions are directed towards lobbying government or regulators to promote change in the investment management environment, whilst others tend to look ‘inwards’ and seek to encourage change from relevant industry agents. Whilst regulation might be part of the solution and necessary framework, collaborative initiatives with a focus on industry-led change was considered most desirable for the case study analyses.

On the basis of these criteria, the three initiatives selected for further study were the Carbon Disclosure Project, the Council of Institutional Investors and the Enhanced Analytics Initiative. Figure 2 summarises the extent to which these initiatives satisfied the case study selection criteria.

Figure 2: Case study selection criteria

Name	Criteria 1: Category	Criteria 2: Leadership	Criteria 3: Membership	Criteria 4: Industry change
Carbon Disclosure Project (CDP)	Climate change	Led by NGO for institutional investors	Global representation	Company disclosure of carbon emissions
Council of Institutional Investors (CII)	Corporate governance	Led by institutional investors	Mainly US, some international membership	Improved corporate governance standards
Enhanced Analytics Initiative (EAI)	Small group initiative	Led by institutional investors	Global representation	Broadening analyst research on extra-financial factors

Data collection and analysis. The case studies were carried out using publicly available information from the respective websites, presentations, reports and published research papers.

The data collected for analysis amounted to over 500 pages in text and was coded and analysed using textual analysis into the following categories:

1. Factual information: This category of data includes an assimilation of key facts about the initiatives such as the date of inception, the number of members, the cost and requirements for membership, the categories of membership available, the core goal/function of the initiative, its functionality and characteristics in terms of how it works on a day-to-day basis. These factors have been classified and presented under the headings ‘Objectives’ and ‘Characteristics’.
2. Evaluation: This category of data includes a critical assessment of the positive and negative features of each initiative, drawing from evidence such as the opinions expressed by others involved in the initiatives (in the form of presentations or public statements), evaluation reports, research studies and academic theories related to cooperation between market agents. These factors have been classified and presented under the headings ‘Positive’ and ‘Negative’ features.

Case Study 1: The Carbon Disclosure Project

Objective

The core function of the CDP project is to “facilitate information request by collaboration of institutional investors” that will “lead to increased awareness of the risks and opportunities from climate change” (<http://www.cdproject.net/faq.asp>). Although not stated explicitly, one can surmise from its activities that it seeks to improve corporate disclosure of carbon emissions such that institutional investors become better engaged and informed on issues related to climate change, and thus more able to integrate the risks and opportunities associated with climate change into their investment decisions.

Characteristics

Request for CO₂ emissions data. The project centres on the dissemination of a questionnaire to global corporations from the CDP secretariat on behalf of the signatory institutional investors. There is no upfront cost or effort on the part of the institutional investors, just their support for the request of information and their agreement to be noted as a signatory. There is no monitoring

or reporting of institutional investors' response to the disclosure of the data, rather the project focuses on information gathering and dissemination. As the website (www.cdproject.net) states:

“The Carbon Disclosure Project (CDP) provides a secretariat for the world's largest institutional investor collaboration on the business implications of climate change. CDP represents an efficient process whereby many institutional investors collectively sign a single global request for disclosure of information on Greenhouse Gas Emissions. CDP has historically sent this request to the FT500 largest companies in the world however in 2006 we have expanded our reach to 2180 companies, with over 950 responding with an answered questionnaire... This web site is the largest registry of corporate greenhouse gas emissions in the world. Responses from corporations can be downloaded without charge.”

Information is free and publicly available. The data collected is publicly available and free of charge on the CDP website. The signatories are publicly disclosed, as are the reports on the companies and their responses given which are analysed by an independent consultancy.

Collaboration with other initiatives. The CDP Secretariat works with the Global Reporting Initiative (GRI) to ensure that this request and the GRI indicators are closely aligned and complementary. The CDP Secretariat also works with the World Economic Forum GHG Registry, which benefits from an auditing standard⁴.

Positive features

Upfront cost of collaboration is zero for investors. There is no upfront cost for signatories as it is free to sign the request for information and to gain access to the company responses. There is also no requirement for the signatories to ‘do anything’ with the data once it has been collected, or to report on their activities or response to climate change risks and opportunities. From that perspective, the cost-benefit analysis of collaboration from the institutional investor perspective is very favourable as it is not only free, but it also brings with it the upside of being publicly seen to be doing something with respect to climate change. It also produces better information on

⁴ “The GRI aims to improve global reporting standards on economic, environmental, and social performance by all organizations. It is a multi-stakeholder global network of over 1000 members. It has developed (and provides free of charge) a Sustainability Reporting Framework, the core of which are the Sustainability Reporting Guidelines. Other components in the Reporting Framework are Sector Supplements and Protocols.” Source: www.globalreporting.org
“In cooperation with the International Emissions Trading Association, the Pew Center on Global Climate Change, the World Business Council for Sustainable Development, the World Energy Council, the World Resources Institute, the World Wildlife Fund and Deloitte Touche Tohmatsu, the World Economic Forum has launched a new global initiative to stimulate the disclosure and management by companies of their worldwide climate emissions.” Source: www.pewclimate.org/we_forum.cfm

carbon emissions should the investors choose to incorporate this into analysis of their investments, but without the requirement to do so.

No effort or skill required amongst collaborators. Another positive feature of this initiative is that it takes almost no time, effort or skill to collaborate; at a minimum, all the institutions need to do is pledge their support. In reality, an institution would no doubt conduct due diligence to ensure that it is something that it wants to be associated with, but thereafter there is no requirement in terms of skill or effort expended.

Short questionnaire less onerous for companies. It has also been said that the brevity of the questionnaire itself is a positive feature of the initiative, since it will likely encourage more companies to participate than other more elaborate questionnaires on this subject. More respondents will, in turn, increase the information collected and the chance of fulfilling the goals of the initiative. As Derek Higgs, Chair of the CDP and author of the Higgs Report (2003) on CG, stated on 17 February 2003:

“And the third reason for applauding the project is because I have never seen a shorter questionnaire. CDP is a very positive aspect of shareholder engagement and if there are more shareholders ready to sign up that can only be a very good thing.”

Efficiency gains. The rise in the number of signatures to the CDP from 35 to 284 in the CDP5 indicates that the project has been effective in gathering support from the investment community. This mobilisation of institutional investors on the issue of climate change is important because it achieves something that could not be done efficiently were each institution to approach companies individually. Efficiency gains are achieved through tapping into the combined power/voice of the institutional investor community and also by reducing the reporting/disclosure costs for the companies themselves.

Risks and opportunities. The primary output of the initiative is improved disclosure of carbon emissions by the participating companies that will allow institutional investors, in principle, to better assess the risks and opportunities of their investments with respect to climate change. The reporting statistics provide information on the companies that replied to the survey and those that declined or only partially replied, which could also potentially be useful information for investors in their analyses and any direct follow up engagement activities with the companies.

Cross-collaborative efforts. Another positive feature of this initiative is its aim to coordinate with other initiatives related to climate change (as mentioned earlier, the GRI and the WEG GHG Registry). Such collaborative efforts are important in moving towards harmonising carbon emissions disclosure standards that will, in turn, make it more efficient for companies to report and for analysts to assess more comparable data.

Negative features

Unclear end-goal/objectives. As argued by Spekman et al (1998), success in an alliance requires the establishment and execution of clearly defined goals, and to achieve these goals, well-defined procedures must be agreed upon and clearly communicated amongst collaborating agents. If the primary goal of the CDP is to build a database of carbon emissions then it is well on its way to achieving that aim. However, it appears to also be driven by a more fundamental desire to mobilise and assist institutional investors to better consider the risks and opportunities of climate change. In the absence of such a goal being made explicit it is not only difficult to assess the success of the initiative in achieving that objective, but it also muddies the long-term planning of the collaborative efforts that might supplement the questionnaire to promote better integration of climate change factors into investment decisions (such as the development of best practice standards for integrating emissions data into investment analysis).

Poor data content and comparability. Despite the efforts of the project coordinators to streamline reporting and coordinate activities with the GRI and WEF, a variety of reporting methodologies still exist and are being used by companies that make benchmarking and comparability difficult. As Paul Dickinson (2006), Coordinator of the CDP noted, 266 companies provided emissions data in CDP3 but only 153 of those (58%) could be accurately benchmarked due to incomparability of data. A variety of methodologies reportedly exist (not all companies are using the WRI/WBSCD GHG Protocol) and the boundaries are unclear as to what method is being used, with varying interpretations of operational boundaries also said to prevail. This lack of comparability undermines the value of the data and could mean that institutional investors still need to approach companies individually to assess climate change risks and opportunities. By further way of evidence, in October 2006 another collaborative initiative called The Global

Framework for Climate Risk Disclosure⁵ issued a set of guidelines to encourage standardised disclosure of climate change risk. The Group noted that despite the efforts of the CDP, the disclosure of information on carbon emissions was insufficient to equip investors with what they need to effectively assess the investment risks and opportunities associated with climate change⁶.

Little effect on company behaviour. The request for disclosure of information will not, in itself, propel companies into action to reduce emissions, particularly if the perception amongst corporations is that most institutional investors are unlikely to critically assess the data. By way of evidence, Dickinson (2006) noted that of the 153 FT500 companies that could be accurately benchmarked in the CDP3 project, only 43% stated that they plan to reduce emissions with a larger 57% predicting an increase. Consequently, whilst the number of companies approached has increased from the FT500 companies to over 2000, this has not corresponded with an increase in companies' stated intention to reduce carbon emissions.

An increase in the number of companies completing the questionnaire over time (45% of the FT500 provided full answers in CDP1 to 72% in CDP4) does not mean that the collaborative efforts are having a positive effect on corporate behaviour. Whilst there are strong incentives for companies to say the right things and be seen to cooperate, the evidence suggests that this might be more of a box ticking exercise than representative of any change in policies or practices. For example, Dickinson (2006) reported that 92% of the CDP3 respondents believe that climate change represents a commercial risk and/or opportunity. However, when questioned about policies less than half (45%) of the respondents had established emissions targets and timeline and only 35% had taken early action in emission trading. On balance the evidence suggests that *reporting* carbon emissions data does not in itself promote change in company behaviour in terms of developing policies and/or future intentions to reduce emissions.

Institutional investors fail to act on the data. As it currently stands, the project does not require any follow up or reporting on the response of the institutional investors to the disclosed data. So harping back to the cost-benefit assessment of collaboration, whilst it might be free and require

⁵ Organisations backing the new guidelines include: the California Public Employees' Retirement System; Ceres; the Institutional Investors Group on Climate Change (IIGCC); and the UN Environment Programme Finance Initiative. It follows a similar initiative from the IIGCC, the Investor Statement on Climate Change, under which the signatories agreed to put pressure on governments and companies to reduce emissions of GHGs.

⁶ Source: Environmental Finance Press Release, "Major Investors Call for Standardised Climate Risk Disclosure", October 13, 2006. <http://www.environmental-finance.com/onlinews/1210iig.htm>

minimal effort, the absence of any measurable assessment of outcomes makes it more likely that collaboration is seen as a box-ticking exercise by many of the participating institutions; a way of being seen to be active whilst effectively doing nothing! Whilst this might sound like a harsh assessment, Matthew Kiernan (2006), Chief Executive of Innovest Strategic Value Advisors who has been closely involved as an advisor to the CDP made the following comments:

“Arguably the most dynamic of these coalitions of institutional investors are currently focused on the specific issue of climate change – a classic Universal Owner issue if ever there was one. The largest of these coalitions, the Carbon Disclosure Project, is a global effort. As of mid-2006, in its fourth annual incarnation, the CDP now brings together over 220 institutions with \$30 trillion in combined assets...

From where I sit, however, all of these proceeding developments are merely prologue: if Universal Owners really want to pursue true social and environmental transformation and broad-based value maximization, they must raise their games to the next level. What is the next level? Simple; it requires putting at least some of their money where their mouths have been for quite some time now...(p.7)

...My own back-of-the envelope guesstimate is that, with the Carbon Disclosure Project, roughly .000000001 percent of the \$30 trillion in supporting institutional assets owned or managed by its over 225 signatories has actually invested in financial products or instruments which have been explicitly informed by company-specific research on climate risk. In other words, it is far from clear that even one of the thirty trillion dollars is actually being invested one iota differently than it was previously...” (2006:9)

Incisive words from an individual close to the initiative that go to the core of successful collaboration; if the majority of the parties involved do not believe that action will benefit them, or are in their best interests, then they will remain unwilling to change their behaviour or their investment practices. Signatories to the CDP appear to support the project as long as it is free (or of minimal cost) in terms of money, skill and effort expended. If they genuinely believed that carbon emissions were a key input into assessing risks and opportunities in their investments then they would be “*putting at least some of their money where their mouths have been*” (Kiernan, 2006:7) and expending resources for the integration of such data into their investment decisions.

Conclusion

At first glance, the CDP appears to be blessed by success with rising coverage in terms of company responses and supporting institutions. However, it seems that participation as a signatory does not necessarily correspond to a change in behaviour in terms of incorporating

carbon emissions data into investment analysis; rather it represents a costless way for institutions to enhance their reputation with minimal effort. This is not to undermine the value of building a database of carbon emissions that may or may not be used by investors in the future, but merely highlights that that's where the benefits currently end. The lesson from this case study is that the end-goal of any collaborative effort needs to be made explicit and measurable (with some imperative to promote change in the behaviour of collaborative agents) to reduce the risk that collaboration becomes a cost effective means of box-ticking.

Case Study 2: The Council of Institutional Investors

Objective

The Council of Institutional Investors (CII) has a clear objective with well specified beliefs that underpin that goal. It is a shareholder rights organisation that “works to educate members and the public about corporate governance and to advocate for strong governance standards on issues ranging from executive compensation to the election of corporate directors.” This goal is underpinned by a belief that institutional investors “are major long-term shareowners with a duty to protect the retirement assets of millions of American workers. CII believes that by pooling their resources, institutional investors can and should use their proxy power to hold the companies in which they invest accountable.” (Source: www.cii.org/about).

Characteristics

Founded in 1985 with 21 members, it now has 140 members including public, union and corporate pension funds with USD 3tr AUM. The Council encourages its member funds to use their proxy votes, shareholder resolutions, pressure on regulators, discussions with companies, and, when necessary, litigation to protect plan assets. The policies developed by the Council are designed to provide guidelines but are non-binding for companies and members.

Development and dissemination of a Corporate Governance policy. The Corporate Governance (CG) policy developed by the Council covers detailed guidance on executive compensation, including non-employee director compensation; the role and structure of the Board of Directors; shareholder voting rights; a definition of independent director; shareholder meetings; and the education of members. The CG principles and definition of an independent director constitute a core part of the Council's efforts to promote strong governance standards.

Development and dissemination of pension fund statements. In addition to its core policies on CG, the Council issues statements on other issues that impact on pension fund statements. For example, it notes that trading commissions are an asset of the plan and as such plan sponsors and trustees need to decide how they are managed through contractual arrangements with money managers and brokers. To this end, the Council has posted guiding principles on trading practices, commission levels, soft dollars and commission recapture.

Development and dissemination of a focus list. Another aspect of the Council's function is to produce a 'focus list' of companies that are poor performers against certain criteria. The most recent annual list was based on poor pay-for-performance practices and included 10 candidate companies (previously 25). This list and detailed pay and governance profiles of each company is shared privately with members before being publicly released ahead of the proxy season. The Council encourages volunteer, diverse groups of general members to arrange dialogues with these companies about their pay practices (but is not directly involved in such discussions). This approach offers members an opportunity to discuss compensation concerns directly with companies, and offers firms an opportunity to commit to better pay-for-performance policies.

Inform and educate members and the public. The Council also seeks to keep its members and the general public informed about its activities and shareholder rights and obligations through writing publications that are publicly available. As well as issuing press statements from time to time, the Council hosts teleconference calls that cover various (changing) topics, for example on Feb. 6, 2006 Internet Availability of Proxy Materials; and Feb. 2, 2006 Majority Voting for Directors. The Council provides a resource centre that includes information on topical issues related to governance and pension fund management such as: stock option backdating; defined benefit plans; majority voting for directors; executive compensation; self-regulatory organizations; Sarbanes-Oxley Act Section 404; and proxy access. Other Council resources include a glossary of CG terms; proxy voting guidelines; background statements; divestment and other issues as they emerge. Its website also contains links and information pertaining to non-council resources that are available, including the Governance Research Center, links to academic studies on CG and proxy voting activities and outcomes.

Advocate to US industry agents and regulators. The Council is also an active voice in advocating industry change to relevant stakeholders through writing letters and correspondence to

individuals and organisations such as the SEC, the Senate Banking Committee, the NYSE, politicians, direct to companies (on generic issues rather than company specific, such as backdating of stock options) and many others depending on the industry issue of concern.

Positive features

Clear objectives and beliefs. The CII has clearly defined objectives and beliefs that underpin those goals (as previously outlined). As such, the guidelines and standards that have been developed are very specific in nature, leaving little room for ambiguity in interpretation by members. Not only does this help to focus and unify the efforts of CII members, but it also makes it easier to assess the effectiveness of the Council's collaborative efforts in meeting its objectives (by way of evidence, studies by Opler and Sokobin (1995), Caton et al (2001) and Song and Szewczyk (2003) have been carried out to assess the effectiveness of CII investor activism and will be reviewed later in this paper).

Powerful and efficient means for achieving change. It has been argued that organized institutional shareholder groups can exercise significant clout at a fairly low cost through coordinated shareholder activism (e.g. Black, 1990). The growth in the CII's membership base to over 140 members and USD 3tr assets under management increases the potential influence over US corporate conduct. Moreover, sharing the costs of research, development and the dissemination of principles and guidelines is a more efficient means for improving CG standards than if each pension fund were to develop such policies individually.

Strong reputation and legitimacy. Mitchell et al. (1997) argued that the extent to which corporate managers will respond to stakeholder demands depends on three key factors, namely power, legitimacy and urgency. The potential power of the CII is significant, as discussed above, whilst the urgency factor might be addressed by the CII's practice of issuing the focus list of poor performing companies. In terms of legitimacy, the CII is often referred to as a leader in the field of shareholder activism in the US, as the following quotations illustrate:

“The Council of Institutional Investors will continue to coordinate efforts and act as a clearinghouse for information.” Source: Shareholder Initiatives in 1995, An Activists Perspective, Nell Minow

“The Council is recognized as a significant voice for institutional shareholder interests.” Source: www.bsr.org

The reputation of a collaborative agent is key to its perceived legitimacy and therefore its ability to not only inspire and unite members, but in the case of the CII's objective, to promote better CG standards in investee companies. As Gifford (2006:9) noted:

“The strength and type of argument used by the investor will affect the legitimacy of the request in the eyes of managers. It is likely that the more a request is directly related to improving the value of a company, the greater the legitimacy of the request.”

The work of Boltanski and Thevenot (1999) on the evolution of conventions is relevant here, as they set out conditions upon which new patterns of behaviour might evolve. One of these conditions was the legitimacy constraint, whereby new patterns of behaviour are more likely to emerge when a group of agents (in this case institutional investors and corporate managers) believe the behaviour is legitimate. In the context of creating and sustaining new conventions and ‘norms’ of behaviour in the investment management process through shareholder activism, legitimacy is therefore one of the key factors contributing to a collaborative initiative's success.

Minimise the risk of corporate retaliation. The CII approach is said to create the ability for institutional investors to place pressure on corporations without individually risking any retaliatory action by the target corporations. This is a feature that many collaborative initiatives could lay claim to, albeit with varying degrees of success. The perceived risk of retaliatory action might be high in cases where, for example, an investment management firm is hired to manage the pension assets of a corporation and in the course of the investment management process, concerns arise about the governance of that corporation. As Bogle (2005) pointed out in the case of private institutional managers, even when potential corporate targets for activism are not *current* clients, the risk of offending a potential *future* client provides a powerful disincentive to act. Collaborative initiatives such as the CII are therefore seen as a way to help mitigate the commercial risks of corporate retaliation. As Vittas (1998:14) wrote, the CII represents:

“...a forum for big institutional shareholders to discuss corporate problems. It regularly publishes a list of the 50 least performing companies and thus exerts pressure on the offending corporate managers without exposing any individual shareholder or pension fund manager to the threat of corporate retaliation.”

Led by, and for, the institutional investor community. The CII collaborative initiative was set up, and led by, the institutional investor community. In addition, membership is voluntary and requires a payment of a not insignificant annual fee. For these reasons, institutional investors are less likely to feel that participation in the CII's activities is an imposition (as regulatory measures

might be perceived) as they have voluntarily opted to join, to pay the annual fee and to benefit from the CII's output that has been designed for and by, the institutional investor community.

Evidence that CII activism improves performance. Some studies on the effectiveness of CII shareholder activism have found that its activities have produced beneficial results. For example, Opler and Sokobin (1995) set out to examine whether coordinated and primarily 'quiet' governance activism generated value by examining the activities of the CII. Specifically, they investigated whether firms that appeared on the focus list of the CII experience improvements in performance in subsequent years. The study covered the period 1991-1993 which included 99 listings and involved the construction of a benchmark portfolio that took size, book-to-market ratio and industry performance into account. They found that firms on the CII list exhibited depressed performance in the three years prior to inclusion on the focus list and significant improvements in performance in the following year⁷. The authors concluded (1995:15) that:

“There is substantial evidence that firms on Council of Institutional Investors focus lists far outperformed the market and reasonable comparison group firms in the 1991-93 period. This is consistent with the view that coordinated institutional shareholder activism is effective.”

A subsequent study by Caton et al (2001) also focused on the activities of the CII by testing the effectiveness of the collaborative effort by examining changes in financial analysts' earnings forecasts and stock market returns for the companies on the focus list on days surrounding release of the list. They measured the performance 'slack' that existed in the named firms to assess the extent to which they could respond to the CII's challenge to improve performance (using Tobin's q ⁸ as the measurement tool where companies are defined to have performance slack if $q > 1$ and no performance slack if its $q < 1$). The study covered the period 1991-95 with 108 companies included in the sample and found that a post-release improvement in stock price

⁷ The stock market performance of firms on the CII list in the year following its listing showed at least 10% higher returns than the S&P500. Over the full sample, the CII portfolio exhibited a mean return of 21.1% in the year after listing compared to the market return of 9.5%. The mean one year stock market performance was found to be 2 times greater than the long-term performance matched portfolio (5.3%) and 5 times greater than the book-to-market matched portfolio (2.2%).

⁸ Tobin's q is the ratio of a company's market value of debt and equity to the replacement cost of its assets, where companies are said to have incentives to invest as long as marginal q is greater than 1.

did occur, but that it was limited to those companies with performance slack, or $q > 1$ ⁹. The authors concluded that:

“...actions by institutional investors do affect the equity values of the companies targeted. The effect is not the same, however, for all companies... Apparently, for this sample, the market expects the spotlight provided by release of the Focus List to produce positive results in companies with the ability to respond.”

A study by Song and Szewczyk (2003) also focused on investigating the impact of the focus list of the CII on targeting poor performing firms for the period 1991-96 but in this case, the benchmark was constructed using the CII procedure¹⁰. Using this benchmark as the basis for comparison in firm performance before and after inclusion in the focus list, the results showed a significant underperformance in focus list firms prior to announcement and an improvement in the subsequent year. However, the difference between the focus list performance and institutional shareholdings to the CII benchmark was not statistically significant, thus the authors concluded (2003:328):

“Overall, the examination of institutional holdings provides little support for the notion that shareholder activism by pension funds is effective. The stock price rebounds during the year after listing for both targeted and benchmark firms reported in Tables 3 and 4 are consistent with the actions of institutional investors who, on balance, increase their holdings of both groups. There is no convincing evidence that institutional investors view the Focus list firms more favourably than the benchmark firms.”

On balance, the studies of the CII confirm that there is a measurable underperformance in firms prior to being included in the focus list, and an improvement in share price performance in the subsequent year; the point of contention is to what extent this difference was found to be significant and what benchmark was used as the unit of comparison.

⁹ The authors concluded that (2001:24) “the release of the Focus List starts the process of re-evaluation for the included companies. For those companies with little chance for improved performance, inclusion on the Focus List is interpreted by the market as bad news initially but tends to stop the slide in stock performance indicated in the pre-release period. For companies with performance slack, however, making the list not only stops the pre-release slide in equity values but also seems to mark an upturn in stock market performance, as indicated by the post-release average abnormal return.”

¹⁰ A subset of S&P500 firms were selected on the basis that the firms must under-perform their S&P industry peers in median one- three- and five-year total stock returns and under-perform the S&P500 index return. These firms are then ranked based on their five year industry adjusted returns. Firms with scores 21-40 from the bottom were then used as the CII benchmark. The data was divided into two sub-periods because it was not standardized prior to 1994.

Negative features

Free-rider problem. Some argue that the CII's efforts to improve CG means that members bear the brunt of the costs whilst non-members share in the rewards in terms of improved firm performance. Indeed, this is one of the perceived risks of many collaborative efforts where non-participants might benefit without expending any effort or contribution to the group's activities. Given that the long-term objective of pension funds is to provide beneficiaries with a secure financial future, the fact that other 'inactive' long-term investors might benefit from their collaborative efforts could be viewed as a positive externality, provided of course that their inaction does not damage the 'active' pension funds ability to fulfil its obligations.

Absence of mutual funds. Continuing with the free-rider theme, the membership composition of the CII is confined to US based public, union and corporate pension funds and does not include the vast assets managed by the US mutual fund industry. The benefits of wider participation in shareholder activism have been expounded by John Bogle (2003) for many years, with calls for the development of a 'federation of long-term investors':

“At least since 1998 – long before the recent spate of corporate and mutual fund scandals – I've been calling for mutual funds and other private institutional investors to make their will known by taking an active, even collective, role in governance. Index funds – the consummate long-term investors, who simply buy and hold the stocks in their benchmark portfolios – now represent 12% of mutual fund assets and an estimated 25% of pension fund assets. Such funds, joined by the active managers who eschew a short-term focus could constitute the core of a federation of long term investors.”

Given that the mutual fund industry has experienced significant growth over recent years with 28% holdings of all listed US equities in 2004 (up from 8% in 1990)¹¹, the potential influence of the CII would be bolstered considerably if the mutual fund industry mobilised its power and collaborated in shareholder activism.

Lack of international focus. Another shortcoming of the CII's activities relate to its focus on US listed equity markets and the apparent absence of scrutinising the governance practices of non-US equity investments and/or collaboration with governance coalitions in other countries. Institutional investors are to varying degrees invested in global equity markets and, as such, they are also exposed to the governance practices of non-US listed equity markets. The CII's apparent

¹¹ Source: US Federal Reserve Board Flow of Funds data

lack of policy with respect to foreign equity holdings and international CG practices leaves open the possibility that international institutional shareholdings by US investors are not monitored as carefully. No evidence of collaboration between the CII and other non-US CG networks was found, despite the potential benefits of sharing information and knowledge regarding local governance activities.

No co-ordinated effort to approach focus list companies. The CII's main activities are to educate, expose and develop guidelines to improve governance standards; it explicitly seeks to avoid getting involved in approaching companies and/or recommending how funds should respond to its research findings. Whilst there is a CII co-ordinated effort in terms of representing members' views to industry bodies and regulators, this is not the case in terms of engaging with companies. The advantage with this approach is that it avoids being prescriptive to member funds, hence minimising the risk of alienating certain members should its recommended response be unsuitable for them. However, it also reduces the potential benefits in terms of the cost savings and increased power from co-ordinating a response and/or request to focus list companies.

Conclusion

The CII collaborative effort has proven to be a powerful and effective way for many US institutional investors to expose and improve CG standards amongst US listed equities. There are important lessons to learn from the design and approach taken by the Council, such as: the clear goals and objectives that have been set; the power and efficiency gains for promoting change in CG standards; its strong reputation and perceived legitimacy amongst market agents; the minimisation of the risk of corporate retaliation to activism; the fact that it is led by, and for, the institutional investor community; and, moreover, the empirical evidence suggests that its activities have a strong association with an improvement in the performance of target companies. On the downside, there is the risk of free-riding by non-contributing market agents such as the mutual fund industry; the apparent lack of international focus in terms of monitoring international governance standards and/or collaborating with international CG networks; and the absence of a co-ordinated effort amongst members in approaching or responding to focus list company research.

Case Study 3: The Enhanced Analytics Initiative

Objective

“The Enhanced Analytics Initiative (EAI) is an international collaboration between asset owners and asset managers aimed at encouraging better investment research, in particular research that takes account of the impact of extra-financial issues on long-term investment” (Source: www.enhancedanalytics.com).

Characteristics

Allocation of broker commissions for extra-financial research. Unlike the other collaborative initiatives analysed in this report that undertake a number of activities, the EAI has one main activity – to allocate a portion of members’ brokerage commissions for the promotion of research on extra-financial issues (EFI). EFIs are defined as factors that have the potential to impact companies’ financial performance or reputation in a material way, but are often overlooked in traditional investment research. Such issues have been defined to include CG, human capital management, value creation or destruction during mergers and acquisitions, or global environmental challenges such as climate change¹². EAI members seek to encourage better EFI research by allocating a minimum 5% of their broker commissions on the basis of how well brokers integrate analysis of EFI. As at March 2007, there were 14 Full members; 9 Associate members (those who do not manage their own assets and therefore do not have a contractual relationship with brokers); and 3 Partner groups with total assets under management estimated at USD 1.8 trillion and brokerage fees of around USD 8 million¹³.

Evaluation process. The evaluation process is carried out by an independent consultant, where the criteria used for evaluation include: 1) coverage of relevant extra-financial issues; 2)

¹² According to the Enhanced Analytics Initiative (www.enhancedanalytics.com), EFIs generally have one or more of the following characteristics, they:

- Tend to be qualitative and not readily quantifiable in monetary terms;
- Relate to externalities not well captured by market mechanisms (e.g. environmental pollution);
- Relate to wider elements of the supply chain (e.g. suppliers, products and services);
- Are the focus of public concern and have a medium to long-term horizon (e.g. global warming).

¹³ The current members are ABP Pension Fund, AGF Asset Management, AXA-IM, Bâtirente, BNP Paribas Asset Management, BT Pension Scheme, CalSTRS, Calvert, CPP Investment Board, Generation Investment Management, Governance 4 Owners, Hermes Pensions Management, Investec Asset Management, La Banque Postale Asset Management, London Pension Fund Authority, MetallRente, Mistra, PGGM, RCM - Allianz Global Investors, SNS REAAL, Robeco, Trades Union Congress (TUC) Superannuation Society, UniSuper and the Universities Superannuation Scheme (USS).

investment relevance of sector and issue analysis; 3) comparative company analysis; 4) coverage of research universe; and 5) overall presentation and originality. Brokers' research outputs (reports, briefings and notes) are evaluated against these five criteria and each report is scored based on a percentage scale, calculated by multiplying its score for quality with its score for coverage (good quality must be combined with coverage in order to be of value to buy-side professionals). The total score for each research provider is calculated by adding together all its research output scores. Brokerage firms are invited to submit research for analysis which are then scrutinised and reduced down to the pieces of research that are most relevant to the goals of the EAI. An evaluation report is written for the EAI members based on the aforementioned process¹⁴.

Cross-collaboration with UN PRI. In January 2007, the EAI and the UN Principles for Responsible Investment (UN PRI) announced a formal alliance whereby signatories of each initiative are invited to join the other¹⁵. Apart from encouraging cross membership, it is hoped that the PRI and EAI collaborative effort will promote the sharing of best practice between their respective members and, in particular, will work on how environmental, social and governance (ESG) issues can be better integrated into mainstream investment processes.

Positive features

Clear objectives and focus. One of the EAI's unique features is its focus on mobilising the contractual relationships that exist between market agents; in this case, its goal to encourage brokerage firms to bolster analysts' research on EFI. The initiative sends the 'price' signal to encourage wider research by brokerage firm analysts, leaving the specifics in terms of implementation up to the firms themselves. The evaluation process is made clear and publicly available to enable brokers to work towards meeting expectations and to maximise their potential gain in terms of commissions earned.

¹⁴ Details of the June 2006 evaluation process and findings are posted online at:

www.enhancedanalytics.com/Fiesta/EDITORIAL/20060615/evaluation/EAIevaluationPublicReportJune2006.pdf

¹⁵ The PRI were developed by a group of leading institutional investors in a process convened by the UN Secretary-General Kofi Annan and implemented by UNEP Finance Initiative and the UN Global Compact. The Principles recommend actions for incorporating environmental, social and governance issues into mainstream investment decision-making and ownership practices. There are now over 120 signatories, together representing in excess of US\$6 trillion in assets.

Good mobilisation of financial strength. The pooling of ‘soft’ commissions (related to trading activity and research) via the contractual relationships that exist between asset managers and brokerage firms has provided the EAI with a position of increased financial strength than individual commission arrangements would generate. The pledge of a minimum 5% of their respective brokerage commission for the best EFI research providers would not hold much sway individually, but collectively it could grow to an amount that is more likely to incentivise change in brokerage research. By way of illustration, the EAI reported (Dec 2006) that the number of research providers had increased from 8 in December 2003 to 33 in the June 2006 assessment. Over the same period, the number of qualifying reports increased from 16 to 173¹⁶. The recently announced collaboration with the UN PRI could potentially bolster the financial base of the initiative if signatories to the UN PRI also opt to join the EAI.

Industry perception of legitimacy. The final point of note is the perceived legitimacy of the initiative, not only due to its unique design but also due to its high profile. For example, two awards have been bestowed upon the initiative, including the Gresham Prize that rewards projects that exemplify innovation and encourages new learning, and the Triple Bottom Line Investment Award which is given to those organisations whose efforts further the cause of sustainable investment. Robert Rubenstein, Director of TBLI, made the following statement (2005):

“Our award complements and highlights organisations that have shown exemplary and superior performance in the field of sustainable business activity. The impact that the Enhanced Analytics Initiative is having on the research community is significant. It is actually forcing them to allocate resources to this type of research which they had not done before, making EAI a very worthy winner of our award.”

The strong praise the initiative has received bolsters its perceived legitimacy and could encourage more brokerage firms to respond to the call for improved EFI research.

Negative features

Research not reflected in buy/sell recommendations. One of the main complaints that members of the initiative have publicly expressed is the lack of integration of EFI into analysts’ buy/sell recommendations. By way of illustration, the onValues report submitted to the EFI entitled ‘A

¹⁶ www.enhancedanalytics.com/Fiesta/EDITORIAL/20060615/evaluation/EAIEvaluationPublicReportJune2006.pdf

time of learning and gearing up', evaluated the period from November 2004 to April 2005. It noted that:

"The challenge remains the actual integration of findings at the level of companies and stocks." (2005:3)

A subsequent report entitled 'Taking stock' (2006:11) evaluated the EFI research for the period May to October 2005 also noted that:

"The 'comparative company analysis' criteria (which includes all aspects related to the integration of extra financials into financial analysis) remains the most challenging area in which to score highly. Most research houses do not yet fully integrate these issues into stock valuations and recommendations."

A more recent evaluation that covered the period from November 2005 to April 2006 entitled 'Strengthening institutional commitment', commented that:

"...the majority of reports still disappoint in that they do not clearly establish a link between the theme- or sector-level analysis and financial analysis at the level of single companies. Often the reader is left with the sensation of 'falling off a cliff' when very rich analysis at the theme or sector level does not break through into the company-specific analysis, or is only described in general terms (with the reader left in the dark as to what extent extra-financials have actually been factored into the valuation of companies in the report)." (2006:3)

"On average, it is easier for Research Providers to provide good quality research at the level of sectors or themes than to include extra-financial aspects in financial analysis at the level of companies." (2006:10)

Overall the comments and evaluation suggest that the integration of EFI into analysts' buy/sell recommendations is lacking. This is not unsurprising as one would expect that the integration of EFI into investment decisions will take a long period of time to consolidate as new knowledge and skills are acquired, but there is the added risk that EFI will remain superfluous to the core valuation process of brokerage firms unless the investor base and the allocation of commissions on offer increases over time.

Small allocation of brokerage fees. The 5% minimum allocation of brokerage fees to promote EFI research amongst analysts is a small proportion of total brokerage fees paid by members, and there is no stated intention to increase this allocation over time. Whilst one member is apparently already allocating more than this minimum requirement (10% as reported in Mercer 2005), the small allocation is exacerbated by the fact that the institutional investor membership base is also quite small despite its reported growth (with commission revenue of around USD 8 million in 2006). Whilst pooling resources is an effective use of the power of member organisations, the

low allocation of a small membership base sends a signal to brokerage firms that EFI research should not dominate their research efforts. In the worse case scenario, the 5% allocation could place an implicit ‘cap’ as to how much time/effort brokerage firms expend on EFI research. It is also more likely that the brokerage firms’ research effort will grow under a 2-team structure whereby the EFI research teams are separate from the mainstream research work. This fragmented approach increases the risk that EFI is viewed by brokers as separate to the core valuation process, thereby having little impact on the way buy/sell recommendations are constructed (Guyatt, 2006:120-122).

Limited membership base. By definition, the membership base is limited to those institutions that have a direct contractual relationship with brokerage firms via commission payments. Whilst members that do not manage funds in-house are still able to join as associate members, the impact of their membership is lessened by the fact that they do not have direct control over the allocation of brokerage commissions (but rather can encourage their fund managers to do so). In addition, some institutions that have a strong in-house fund management and research team might see less need or imperative to join the EAI, since they are less reliant on the recommendations made by analysts within brokerage firms (although analyst recommendations will impact on company valuations and market pricing and therefore impact on the portfolio performance).

Early announcement to disband. The chairperson of the EAI, David Blood, has publicly set a time limit in which the EAI is set to disband.

“The EAI wants to raise awareness, see the quality of research improved and then disband,” said Blood. “And in two to three years, we expect to achieve that, although it could take a little more or less time. We were never looking to be a permanent group.”

Source: EAI ‘to disband by 2010’ by Damian Clarkson 01-02-2007, Global Pensions

Whilst it is natural to expect that all collaborative initiatives will eventually be unwound as they achieve their objectives, this public statement potentially undermines the efforts of the initiative for a number of reasons. First, it is unlikely that the goals of the EAI would have been met within a few years as a notable shift in analysts’ research and valuation framework will take a much longer period of time to put into effect. Second, it reduces the incentive for new members to join the EAI if it is only expected to exist for another few years which, in turn, limits the EAI’s power

and ability to influence broker research. Finally, it reduces the incentive for brokerage firms to implement significant changes to their internal research processes and allocation of resources if the future financial incentives for such activities, via commission payments, are uncertain.

Risk that it is viewed as an SRI-related initiative. Another factor that might limit the membership base and influence over broker research is if the EAI is viewed as a Socially Responsible Investment (SRI) related initiative. It is possible that some mainstream institutions that do not wish to identify themselves with such a movement might not join (even if they believe that intangibles are not adequately reflected in valuations). The brokerage firms might also respond to the initiative as a ‘niche’ market for SRI related institutions, again increasing the risk that such factors do not get integrated into core buy/sell recommendations. By way of example, the recent collaboration between the UN PRI and the EAI makes explicit a link to ‘responsible investment’ since that is one of the core goals of the UN PRI. Further signals or ‘clues’ that might suggest to others that the EAI is an SRI-related initiative are contained within a report on the importance of EFI authored by O’Loughlin and Thamotheram (2006). This report mentioned SRI 7 times, the first of which appeared in the forward by Peter Moon, Chief Investment Officer of USS who noted the different responses to investment risks that might exist between hedge funds and SRI managers (2006:3). The report also mentioned that despite the different cultures that prevail amongst EAI members (2006:7):

“...EAI members do not seek to conduct all research through in-house teams, or expect their SRI/CG analysts to cover all issues in all stocks in all markets, occasionally with the aid of specially commissioned broker research.”

A mention of SRI and CG in this way presupposes that members might have specialist teams and, by implication, signals that there is an association between SRI and the EAI. Another comment from ‘inside’ the EAI by Moon (2006:21) on EAI membership noted:

“But not all fund managers have, as yet, decided to join EAI. It is particularly surprising that this includes many fund managers who have a formal commitment to corporate governance or SRI.”

The expectation that SRI fund managers would be *more* likely to join the EAI than traditional investors again reinforces the perception that SRI underpins the beliefs behind the initiative and, by implication, could (rightly or wrongly) act as a disincentive for some institutions to join.

No minimum hurdle or standards set. Another possible disincentive for new members to join is the risk that EFI related research activities could be sub-par, yet members are committed to divert a minimum 5% portion of their brokerage commissions regardless of the quality. Whilst there is a well-defined evaluation procedure in place (as described earlier), this is primarily based on an assessment of how well each brokerage firm did against certain criteria and are ranked against each other. There is no established benchmark or minimum standard upon which the research output can be compared against to determine whether the quality is high enough to justify *any* diversion of commission payments. Members could, in the worse case scenario, be committed to selecting and rewarding the best research out of a bad bunch, leading to a misallocation of resources. So, even though “*the majority of reports still disappoint in that they do not clearly establish a link between the theme- or sector-level analysis and financial analysis at the level of single companies*” (EAI June 2006 Evaluation of sell-side extra-financial research, page 3), the best of the bunch will still get rewarded with a diversion of commission fees.

Lack of uniformity in disclosing and reporting on brokerage fees paid. The evaluation procedure produces the highest ranking brokerage firms and describes them as those ‘eligible’ for EAI commissions, but the determination and payment of such fees is then left to each individual member. There are three main risks with this approach: 1) members could interpret the results differently to each other and therefore send mixed signals to brokerage firms about the initiative’s expectations; 2) brokerage firms seek clarity and some level of predictability in terms of commission payments in order to justify the increased investment in new skills and knowledge. If EAI members loosely interpret the evaluation reviews every half-year this could create a disincentive to change the core valuation process as the risk/reward is an uncertain 5% of revenue commissions versus a more certain 95% (as the process is more entrenched and therefore predictable); and 3) potentially creates a blurring of the reward structure, as behind-the-scenes negotiations increase the risk that ‘other’ factors might fall into the computations of brokerage commissions, particularly if EAI members are not required to disclose the precise figures that have been allocated.

Conclusion

The EAI is a unique and well-designed initiative with a clearly defined objective and focus. By singularly focusing on contractual relationships that exist between fund managers and brokerage

firms, the EAI has been designed to amplify its financial strength whilst containing upfront costs, since most of the financial commitment takes place via a redistribution of brokerage commissions. It is widely considered to be a credible and well-regarded initiative within the investment community, having been awarded prizes in recognition of its pioneering approach to collaboration. On the downside, negative signals have been sent to brokerage firms and potential members that suggest the EAI could be a niche need to service, such as the early announcement of plans to disband, the small allocation of brokerage fees and the link to SRI-related activities. These factors could restrict the EAI's membership base and the resources/effort expended by brokerage firms, as indicated by the still insufficient integration of EFI into analysts' valuations and buy/sell recommendations.

Addendum to Case Study 3: Collaboration between the EAI and the UN PRI

The following section presents some of the positive and negative factors associated with the new cooperative arrangement announced in January 2007 between the EAI and the UN PRI initiatives. The analysis focuses on the broad 'in principle' implications rather than the intricate workings and administrative arrangements that have been agreed between the two groups.

Positives

Expand pooled membership. Both groups stand to benefit from some increase in their membership base should all members opt to be signatories of both initiatives. At the time of writing, a comparison of the membership profile for each group revealed that there was an overlap of only 11 members, with a potential increase in the UN PRI signatories of 12 (organisations that are members of the EAI but not the PRI) whilst the EAI potentially stood to gain around 130 signatories if *all* the PRI members opted to join the EAI¹⁷. Of these potential signatories, over 50 are from the 'asset owners' category; around another 50 are global investment managers; and over 30 professional service partners. In numerical terms, the UN PRI has a much larger membership base with signatories representing over USD 6tr AUM, increasing the potential pool of signatories to the EAI which by comparison was around USD 1tr AUM (at

¹⁷ These calculations were based on the membership figures as at 19 January 2007, as posted on the respective websites of the UN PRI and the EAI.

the end of 2006). Thus whilst each group stands to benefit from some net increase in the number of signatories, it is the EAI's representation and power that could be bolstered the most from this collaborative agreement.

Narrow the UN principles/implementation gap. The potential 'win' for the UN PRI is the narrowing of the gap between signing the principles and implementation of an appropriate policy. Given that the UN PRI is based on voluntary principles rather than providing specific guidance as to how to implement these, the practical nature of the EAI might assist in PRI signatories' deliberations. For example, whilst not part of the whole solution to implementing the principles, the EAI addresses aspects of the UN PRI that deal with the integration of ESG factors into the investment decision making process (such as Principles 1 and 4¹⁸). The EAI's focus on improving the research output and valuation methods as provided by brokerage firms could assist the UN PRI signatories in implementation. As well as providing these potential benefits for the PRI initiative, a narrowing in the principles to implementation gap could help the EAI project to overcome the problem of broker research not being incorporated into buy/sell recommendations (since there will potentially be a larger pool of resources to exert power over brokerage research).

Negatives

Reduce the clarity and focus of the EAI. As argued earlier in this report, one of the key strengths of the EAI is its simplicity and clarity in terms of what it seeks to achieve and through what channels. Collaboration between the EAI and the UN PRI reduces the clarity and potentially muddies the focus of the EAI for a number of reasons. First, there is a notable difference in the terminology and definitions used to describe the task at hand that could be confusing for members and relevant market agents. The EAI refer to EFI and define these as the fundamental factors that are often overlooked in valuations, whilst the PRI refer to ESG factors which is the terminology now most commonly used by the responsible investment community. Invariably, integration of ESG factors has been defined to mean investment decisions and policies that take into consideration their impact on, and/or relationship to, the environment, social and CG considerations.

¹⁸ For example, Principle 1 of the UN PRI states: We will incorporate ESG issues into investment analysis and decision-making processes. Principle 4 states: We will promote acceptance and implementation of the Principles within the investment industry. Source: www.unpri.org

The second way that collaboration could undermine the clarity of the EAI is related to the difference in the interests and objectives of the respective groups' membership base. In the case of the EAI it has a very clear and targeted objective and financial commitment, concerned only with improving brokerage research. The UN PRI on the other hand represents a much broader set of principles that are not directly measurable or targeted towards change in specific agent behaviour. Whilst there are synergies between the two groups (as outlined earlier) there will also be some members of the latter that might consider the financial commitment to the EAI to be unnecessary (particularly if they have their own research capacity) and/or some EAI members to consider the PRI onerous in its breadth and scope.

Increase the EAI's perceived link to SRI. Whilst the UN PRI does not claim to be an SRI initiative as such¹⁹, its pursuit of 'responsible investment' and apparent compatibility with the approach taken by many socially responsible investment managers, means that it will be viewed by many in the investment community as an SRI-related activity. As it stands, this has not thwarted growth in the membership base of the UN PRI; signing the UN principles offers the benefit of being seen to be a 'responsible investor' without having to make any upfront financial commitment or to take specific action over any particular time period (with no ramifications for non-compliance). Despite these apparent benefits, from the perspective of some EAI members it is possible that a link to an association with SRI related objectives might not be viewed favourably either due to perceived reputational risks and/or a general resistance to the broader notion of responsible investment.

¹⁹ On the distinction between the UN PRI and SRI, the UN notes that "the principles are designed to be compatible with the investment styles of large, diversified institutional investors that operate within a traditional fiduciary framework. The Principles apply across the whole investment business and are not designed to be relevant only to SRI products. However, the Principles do point to a number of approaches – such as active ownership and the integration of ESG issues into investment analysis – that SRI and many corporate governance fund managers also practice". The UN Principles of Responsible Investment document (2006:6). Source: www.unpri.org.

Towards building a collaborative framework

So far in this report, the key features of over 30 collaborative initiatives have been reviewed with more detailed analysis of the positive and negative features of the CDP, the CII and the EAI (in addition to the collaboration between the EAI and the UN PRI initiatives). Drawing from these case studies, some of the lessons in building a framework for the design and identification of ‘win-win’ collaborative opportunities are summarised below:

1. Have a well-defined goal and objective
2. Be clear about the change being sought and the agents being targeted
3. Partners to genuinely believe that it is in their self-interest to participate in the initiative
4. Recognise the heterogeneous nature of Partners and design collaborative initiatives accordingly
5. Focus on the power relations between agents to mobilise change more effectively
6. Keep costs to a minimum in terms of upfront fees and the time, effort and skill required
7. Measure and review the success of the initiative over time
8. Follow through and co-ordinate the activities of Partners as far as possible to ensure consistency in output
9. Trust and perception of legitimacy is key to the initiative’s success in mobilising change, including high profile Partners and credible aims and methods
10. Global, cross-collaborative initiatives increase power and potential influence but need to be thoughtfully designed so as not to lose focus

There are obvious tradeoffs inherent in many of the points summarised above that deserve further attention. For example, keeping costs to a minimum whilst ensuring there is some follow-through and measurement of success will be a challenge to manage. There will also need to be clearly defined boundaries as to when a large, global cross-collaborative initiative might be preferable to a small, targeted group of partners. Drawing from these insights, the motivation for collaboration and the development of a theoretical framework for identifying win-win collaborative opportunities will now be examined.

Part III: Theoretical framework for identifying ‘win-win’ collaborative opportunities

“...the ‘market’ is not something that is outside us; rather, it is us. How we perceive it, how we want it to be, and how we study it are inextricably intertwined.”

Frankfurter et al (2004:465)

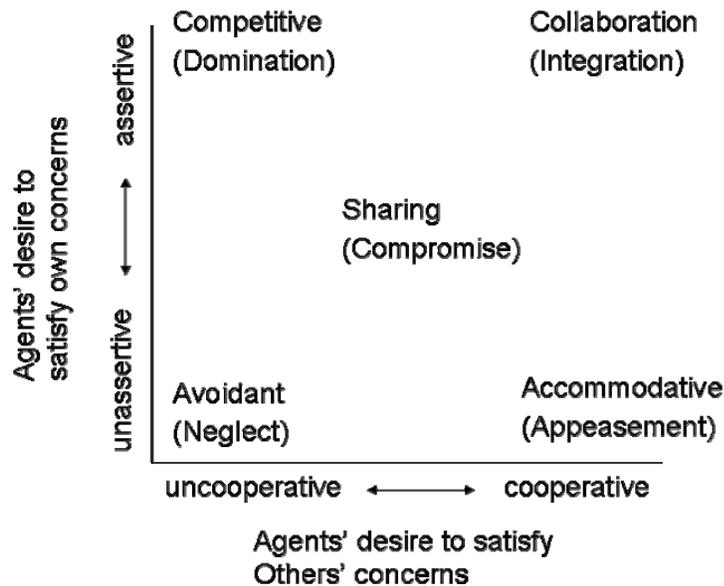
Introduction

This section reviews some of the academic literature related to the notion of collaboration including game theory, evolutionary game theory, evolution of cooperation and evolution of conventions. It will be argued that the key component of any collaborative initiative is the pursuit of self-interest and that, whilst this might be a fixed goal, the inputs that determine self-interest are time varying and will differ by agent type. The drivers of self-interest and the motivation to collaborate can be reduced down to an agent's beliefs, priorities and perception of legitimacy. An eight step process for identifying, evaluating and implementing a collaborative initiative will be presented, starting with a clear specification of the problem, followed by identification of the target agent(s) for change and the power relations that prevail. The motivation to collaborate will be a key test of viability for any initiative, before moving on to consider its optimal design, implementation and ongoing evaluation.

The meaning of 'win-win' in a collaborative setting

The term 'win-win' first emerged in game theory literature in situations of conflict, where the strategies adopted by interacting agents were said to have the potential to produce winning or losing outcomes, depending on an individual's decision and the decision of others playing the game (Schelling, 1960). Win-win in the early management conflict literature was defined as an integrative solution (Walton and McKersie, 1965; Thomas, 1976), meaning that the situation is a positive-sum game and that all parties could gain through exploration of the sources of conflict (Figure 3, top right hand corner). In contrast, an either-or or win-lose outcome were considered representative of distributive bargaining in which the positions of the conflicting parties are mutually exclusive. This was also described as a zero-sum game whereby the gains from cooperation are fixed; hence one party's gain is another party's loss. The competitive and accommodative styles represented in Figure 3, use either domination or appeasement as their primary behaviour, whereas the avoidant and sharing styles tend to be representative of patterns of neglect and compromise respectively.

Figure 3: Conflict management styles



Source: McNary (2003:146) as adapted from Thomas, K.W (1976:900)

Collaboration has also been used to study the ability of individuals to coordinate their behaviour in situations without any strong conflict of interest, but where successful coordination would potentially produce benefits for all parties (Axelrod, 1984). The ‘win-win’ outcome is therefore, as the name suggests the strategy that produces a net benefit for all interacting agents in a conflict management or collaborative setting. There are three additional points to make regarding the meaning of ‘win-win’: firstly, that collaboration is not, in itself, a winning formula; secondly, that ‘win-win’ is not interchangeable with a compromise solution; and thirdly, that the pursuit of self-interest is the primary goal (not group-interest) and this will be dependent on an agent’s priorities, beliefs and perception of legitimacy.

Collaboration is not, in itself, a winning formula

Collaboration for collaboration’s sake could be a costly and wasteful exercise. Not all forms of collaboration will produce winning outcomes for one or all of the collaborative agents, regardless of how good agents’ intentions are at the outset (Diamantoudi and Xue, 2002). The case studies examined in Part II of this report highlighted a number of factors that need to be taken into consideration in formulating and sustaining a successful collaborative project. First, it illustrated that an honest and careful appraisal of the self-interested motivation of all agents must be

factored into the design of any collaborative initiative to maximise its chance of success. Each participating agent must genuinely believe that collaboration will be beneficial for themselves and/or for their institution. If this basic condition is not satisfied then collaboration is unlikely to succeed. Second, it is necessary for any collaborative initiative to have a clear and measurable objective with clearly defined responsibilities, monitoring of performance and reporting. Some of the potential downsides of collaboration also need to be taken into consideration, such as the risk of increased bureaucracy of decision-making, the time/effort required, the long lead times to implementing change and free-riding of non-collaborative agents (Sullivan and Mackenzie, 2006:336).

Finally, in theory collective decision-making has the potential to increase systemic risk if the collaborative agents are pursuing a strategy that ‘goes wrong’. It is for this reason that collaboration is best thought of as a means to an end; coordinating activities with a view to achieving a specific change or improvement in the pension fund management process. It should not be overly demanding in terms of prescribing specific actions or reduce agent autonomy, nor should it be considered something that is permanent; as and when behaviour and industry-wide change emerges the need for collaboration will subside.

The notion of ‘win-win’ is not the same as a compromise solution

McNary (2003) argued that the term ‘win-win’ has been misused by the business community over the years and has now come to mean something that is almost opposite to its original meaning. McNary noted that (2003:147):

“...it is important to observe that the original meaning of the terms ‘collaborative’ or ‘integrative’ are NOT synonymous with the term “win-win,” which is used to denote that both parties “win” in a conflict episode. Yet the terms are often used interchangeably.”

McNary argued that the common usage of the term ‘win-win’ in the business community and popular press implies that ‘win-win’ is akin to a model of long-term problem solving based on integration, cooperation and synergy. This has perpetuated the misuse of ‘win-win’ from its original meaning where it is often used interchangeably with ‘compromise’, the latter meaning that both parties make concessions to come to an agreement. In a conflict situation, whilst a compromise outcome would produce some sort of result it is not necessarily one that would produce a win-win (net benefit) for all interacting agents. Power dynamics and negotiation skills

will inevitably influence the extent to which a compromise agreement is more favourable for one set of agents than another. In a voluntary collaborative framework, it would be inappropriate for interacting agents to enter into a compromise agreement if they don't believe that it will produce a net benefit. In this situation, a superior choice for some or all of the interacting agents would be to reject collaboration as a means to an end, rather than to voluntarily enter into a compromise situation that may not be beneficial.

Self-interest can motivate agents to collaborate

The challenge facing institutional investors and their agents is how to best mobilise their power and potential influence through cooperating with each other, whilst recognising that individuals are inherently self-interested. Axelrod (1984:3) eloquently summed up this dilemma:

“Under what conditions will cooperation emerge in a world of egoists without central authority? This question has intrigued people for a long time. And for good reason. We all know that people are not angels, and that they tend to look after themselves and their own first. Yet we also know that cooperation does occur and that our civilisation is based upon it. But, in situations where each individual has an incentive to be selfish, how can cooperation ever develop?”

The interesting point made by Axelrod is that, even though individuals are self-interested and have disparate objectives, they still cooperate with each other. The long list of collaborative projects that prevail amongst institutional investors (as presented in Section I) are proof that cooperation can and does prevail outside a central authority. Indeed, Axelrod argued that in some situations it is the pursuit of self-interest that actually motivates individuals to coordinate their activities as a means of reducing the risk of decision-making under uncertainty and to capitalise on the potential economies of scale in pooling resources, knowledge, power and influence.

A wider interpretation of self-interest is required

The assumption that rational economic man seeks to maximise utility via wealth maximisation is narrow in its portrayal of agent behaviour as it fails to take into account the broader social, economic and psychological influences on decision making. Behavioural financiers have identified biases that emanate from the social and psychological influences on decision making such as the use of heuristics (Kahneman and Tversky, 1979), short-term fads (Shleifer, 2000), speculative bubbles (Shiller, 2000) and herding behaviour (Sias, 2004). Others have written of social goals and altruism as a form of utility maximisation (Margolis, 1982) with recent

examples in the world of business and finance adding weight to the idea that individuals reap satisfaction from helping others²⁰. Whilst such behaviour might still be a form of self-interest if it makes the donors feel better about themselves or it reflects a desire to obtain positive affirmation from others (Elster, 1986), it is still beyond the scope of the classical definition of rational economic man that is driven only by wealth maximisation.

The challenge to the notion of rational economic man is not so much a challenge to the idea that individuals are self-interested, but rather that the framing of self-interest is too narrowly defined. This is relevant for defining ‘win-win’ since it goes to the core of how we think about the ‘net benefit’ of collaborating with others. Some argue that a ‘win-win’ outcome can be achieved through a combination of pursuing group-level and individual-level goals. For example, Hoffman et al (1999) argued that a mixed-motive solution could exist whereby agents seek to simultaneously maximise total group benefits alongside their individual portion of those benefits. The problem with this argument is that there is no evidence to suggest that group-level motivation will persist alongside self-interested motivations over time.

In summary, the interpretation of what is a ‘winning outcome’ or net benefit will differ from agent to agent. It is not valid or necessary to assume that what one agent might interpret as a cost or a benefit will be the same as another agent, but rather that individually they believe that the value of collaboration is likely to produce a net benefit for them and/or their representative institution. Whilst the maximisation of self-interest might be consistent with maximising the total group benefits, that in itself is not the motivating force that underpins a desire to collaborate but rather is a bi-product of the pursuit of self-interest as defined above. This is an important distinction to make in considering the optimal design of a collaborative initiative as it will not only determine the initial appeal of collaborating, but also the extent to which the momentum behind the initiative is sustained over time.

²⁰ The Gates Foundation and the generous contribution made by Warren Buffett to that foundation (a pledge of 10 million Berkshire B stock shares of around \$US 30bn in value to be distributed in 5% pa allotments commencing in 2006) are current examples of how individuals within the corporate and investment industries have wider motivations than profit maximisation.

The contribution and limits of game theory

Any consideration of collaboration would not be complete without drawing from the insights from game theory in framing the interdependencies of interacting agents and the pursuit of self-interest. As defined by Colman (1982:3):

“Game theory is a branch of mathematics devoted to the logic of decision making in social interactions. It is applicable to any social interaction with the following three properties:

- (a) there are two or more decision makers, called players;
- (b) each player has a choice of two or more ways of acting, called strategies, such that the outcome of the interaction depends on the strategy choices of all the players;
- (c) the players have well-defined preferences among the possible outcomes, so that numerical payoffs reflecting these preferences can be assigned to all players for all outcomes.”

Game theory is primarily concerned with the notion of interdependent decision-making. Through a framework of experimental ‘games’, it seeks to determine the rational course of action for players and the likely outcome based on the number and type of players, strategies and payoffs.

It will be argued that classical game theory as developed by Neumann and Morgenstern (1944) cannot be strictly applied to the study of collaboration amongst pension funds and their agents. The reason is that it requires specification of what moves or actions are available to each player, how the moves are made and what outcome is associated with each possible combination of decisions by all the players. Underlying the rules of the game are unrealistic assumptions of rationality, static two or three-person games and complete information. The assumption of complete information means that players would not only have to know the rules of the game but that they would have computed their own payoff function and the payoff function of the other player(s) in the game. As Simon (1982) argued, people have limited knowledge of their situations, limited ability to process information and limited time to make choices. People are therefore likely to use rules of thumb and heuristics in determining an optimal response (rather than detailed calculations of payoffs), reverting to a combination of trial and error, imitating the behaviour of others (Kahneman and Tversky, 1979) and adhering to prevailing conventions and norms (Lewis, 1969).

Games that assume rationality and are restricted to 2 or 3 person static games with complete information are not representative of multi-member, multi-dimensional investor collaboration initiatives with incomplete information and time-varying beliefs and priorities. The assumption

of rationality therefore fails to capture the reality of the investment environment or the decision making process of pension funds and their agents. As noted by Colman, (1982:6):

“...if the game does not correspond to social reality in important particulars, then its practical value is at best limited; and if it does not yield insights that transcend a common-sense understanding of the social interaction, then it serves no useful purpose at all.” Colman (1982:6)

Self-interest and the Prisoner’s Dilemma

One of the basic problems with the notion of cooperation is that the pursuit of self-interest can lead to a poor outcome for all interacting agents. The Prisoner’s Dilemma is the classic game that is most often used to study such situations²¹. In this game, there are two players who have two choices – to defect or cooperate. The choices are made in the absence of knowledge about what the other player will do, and defection yields the highest payoff. The dilemma is that if both players defect then they will both be worse off than if they had cooperated.

Figure 4 shows how the game works. Player 1 chooses a row and Player 2 simultaneously chooses a column to either cooperate or defect (the payoffs to Player 1 are listed first). In the example provided, the numbers denote the number of months spent in prison, where -3 = 3 months in prison and so on.

Figure 4: The Prisoner’s Dilemma*

		Player 2	
		Cooperate	Defect
Player 1	Cooperate	-1, -1 win-win	-6, 0 lose-win a lot
	Defect	0, -6 win-lose a lot	-3, -3 Lose-lose

*Example adapted from Axelrod (1984:8)

²¹ Flood and Dresher framed the Prisoner’s Dilemma in 1950, to be later formalised by Tucker. The original discussion of the game considered a situation where two prisoners who were partners in a crime were being questioned in separate rooms. Each prisoner has a choice of confessing to the crime, and thereby implicating the other, or denying that she/he had participated in the crime. If only one player confesses then she/he would go free and the other prisoner would have to spend a term in prison (say, 6 months). If both prisoners deny being involved then they will both be held for 1 month or if both players confessed they would both be held for 3 months (Varian, 1987:470).

The Nash equilibrium strategy is that players defect and confess to the crime²², since the options for each player are either to confess and spend no time in jail (if the other prisoner denies the crime) or confess and spend 3 months in jail if the other player confesses to the crime (still less than the potential for the maximum sentence of 6 months). However, as the matrix illustrates, this is not the Pareto efficient outcome; cooperate, cooperate would make both players better off with a maximum prison term of 1 month each. Axelrod (1984:32-54) showed that the superior strategy to adopt in a Prisoner's Dilemma game is to engage in a tit-for-tat (TFT) strategy, whereby Player 2 mirrors the decision taken by Player 1 in the previous turn, so that a defection is followed by a defection and cooperation followed by cooperation, and so on. Axelrod concluded that the TFT strategy benefits from its own clarity and transparency, the key elements of which are to be: 1) nice (not to be the first to defect); 2) retaliatory (to discourage others from defecting); 3) forgiving (to restore cooperation should it break down); and 4) clear (intelligible and favourable for long-term cooperation).

The key question for the purposes of this study is whether the Prisoner's Dilemma game and the TFT strategy can be used to represent a pension fund's payoff matrix for opting to collaborate (or not) in lengthening the investment horizon and/or improving corporate and pension fund governance standards. The first practical limitation is that it still relies on an assumption of rationality and therefore requires interacting agents to formally specify their expected payoffs and also what these would be for all other participants in the group. This assumption is unrealistic for the aforementioned reasons. Secondly, there are more than 2 interacting agents in the pension fund collaborative setting, which is more than the Prisoner's Dilemma game normally accommodates. Whilst there have been some attempts to increase the number of individuals beyond the 2-person game, these studies have found that multi-agent cooperation is usually more difficult to model and arrive at a solution in the Prisoner's Dilemma framework (Taylor, 1976; Joshi, 1987; and Cave, 1984 as cited in Axelrod, 1988). The Prisoner's Dilemma game and the TFT strategy is therefore not representative of the coordination problem facing pension funds and their agents. It does, however, highlight the prevalence of 'free-riding' as a potentially limiting factor of any collaborative proposal.

²² The Nash equilibrium exists where there is a dominant strategy equilibrium that exists, whereby each player has the same optimal choice independent of the other player.

The free-rider hurdle

The shareholder activism example

The potential for individuals to ‘free-ride’ off the activities of others could limit the attractiveness and indeed, effectiveness, of collaboration amongst interacting agents. Shareholder activism by some institutional investors to improve corporate governance standards has magnified the heterogeneous nature of institutional investors. Whilst some fund management firms²³ have led the charge in shareholder activism (predominantly public pension funds or hybrid funds that invest on behalf of public sector employees²⁴), others have sat on their hands and opted to ‘do nothing’ (such as mutual funds and many company pension fund schemes)²⁵. This may be of concern for pension funds that have (or are contemplating) shareholder activism, as it not only means that other market agents are getting ‘something for nothing’ without taking any risks, but it could also undermine the potential effectiveness of such activities if only a minority voice places pressure on companies to improve their governance standards.

The eminent Jack Bogle (2005) has long called for mutual funds to become more active stewards of corporate equity holdings, advocating the development of a ‘federation of long term investors’; unfortunately as Bogle himself notes (2005:127) such calls remain unheeded. He describes the free-rider hurdle that has prevented mutual fund managers from getting involved in the promotion of better corporate governance standards as follows:

“Passivity in governance, furthermore, earns a high score on the cost-benefit scale. Let others undertake the hard work, the high profile, and, however moderate in the grand scheme of things, the costs of activism. If their efforts are successful, the passive investors who hold, say, the remaining 95 to 99 percent of the target company’s shares spends nothing but reap substantial rewards. What is more, they also benefit by increasing their chances of luring away the pension and thrift plans managed by the activists. The decision to remain silent, then, becomes a sort of “win-win” decision for the do-nothing investor.” Bogle, 2005:84)

²³ Fund management firms will be broadly defined as private financial institutions that offer a product or service either directly to the public (retail products) or to the institutional investment management community (wholesale products).

²⁴ Such as CalPERS and TIAA-CREF in the US and UniSuper in Australia.

²⁵ Davis et al (2006:75) argue that corporate pension plans do not represent their members’ interests but rather the interests of the company itself. They suggest that the reason is that most global pension funds operate with no member representation on the trustee board but are predominantly run by company officials. These officials, in turn, hire and fire fund managers who have a commercial interest in maintaining strong relations so as not to jeopardise other business opportunities such as underwriting and investment banking services. The fund managers therefore have little incentive to be active shareholders as they may be viewed as ‘trouble-makers’ in the corporate world.

This comment illustrates that agents have different self-interests, beliefs and priorities that impact on the extent to which either free-riding or active participation in a collaborative initiative are preferable. In the case of the mutual fund industry, the managers are motivated by a desire to build assets, develop a large product suite of funds and to charge fees that are competitive but the maximum that customers are willing to pay, including manager fees and those for marketing and distribution (Bogle, 2005:170). Other studies have pointed to the cost pressure that shareholder activism would create for fund managers; for example Pozen (1994) noted that a fund's fee scale could become less competitive due to activism costs, and Downes et al (1999) found that the time and money expended in activism is viewed by some fund managers as a cost that could potentially be damaging to business relations and firm performance. Downes et al (1999) interviewed a number of investors on this subject and found that whilst some investors were willing to accept that activism works in improving long-term shareholder value, they were still unwilling to engage in it themselves, as the following quote illustrates:

“We benefit in a passive way by ‘piggybacking’ on the efforts of activist investors – we accomplish our goals without any publicity or manpower costs.” (Statement made by investor E, from Downes et al, 1999:33)

Consequently, whilst individually fund managers might believe that increased shareholder activism could improve market and portfolio returns, it does not follow that participating in shareholder activism will be appealing since they stand to benefit regardless of active involvement; so even if they hold favourable beliefs toward the notion of shareholder activism, the low priority due to fee and competitive pressures reduces the incentive to act.

Is ‘demand push’ the answer?

In the absence of a market incentive or government regulation to challenge the industry, voluntary collaboration initiatives will need to be designed in a way that appeals to fund management firms' desire to ‘asset build’ (Davis et al, 2006). There are proposals that focus on developing a ‘market’ for voting and proxy services such as the Global Proxy Exchange project (Holton, 2006). Such an initiative proposes a separation of the activism component of corporate ownership responsibilities from the day-to-day buy/sell decisions of fund managers by offering it as a stand alone product for exchange in the market. An innovative proposal that goes to the core of the fund management industry's self-interest – a new product to sell to the public! It also

uniquely focuses on the question of mobilising individual investor beliefs and priorities such that they might become more active in determining how their long-term savings are invested. As it currently stands, there is some ‘market demand’ for corporate activism being met within the fund management industry in its current form, such as the SRI and corporate governance products that focus to varying degrees on shareholder activism and citizenship. A recent emergence of ‘engagement overlay’ products amongst some of the larger fund management firms in the UK have become available for pension funds and other institutional investors (Sullivan and Mackenzie, 2006). However, products that truly integrate an activist investment approach are very much at the margin internationally²⁶ and tend to be internalised into specific industry or company schemes rather than offered as a stand alone product²⁷. This suggests either that there is little demand from end investors for engagement and shareholder activism, or more optimistically, that the demand would evolve as such products were developed and more widely offered in the market.

Before embarking on a project of end-investor demand creation for shareholder activism through the creation of a new ‘product’ – as Bogle rightly points out the ‘product culture’ is one of the fundamental problems with the way the fund management industry operates – it is important to build the right foundations in terms of establishing guidelines for clear disclosure of the activities and expenses of such funds, the source of value creation and distribution of returns that investors might expect and, moreover, a large-scale effort to educate and better inform the public on their economic interests. On the latter point, Bogle (2005:210) suggested that full disclosure of expense ratios, transaction costs and sales charges is needed for end-investors to be able to make informed decisions; as well as the development of a ‘special investor advocacy commission’ that is devoted to improving knowledge of individual investors so that they might better gauge what is, and is not, in their best interest.

²⁶ Haigh and Hazelton (2004) recently estimated that SRI funds under management (retail and wholesale) accounted for no more than 0.4 percent of total funds under management in Europe between December 1999-2001; 0.2 percent in the US for the period September 2000-2002 and 0.3 percent in Australia over the same period.

²⁷ Examples of ‘product providers’ to the public include the hybrid pension plan TIAA-CREF in the US and the superannuation fund UniSuper in Australia. Other pension funds such as CalPERS, Ontario Teachers’ Pension Plan and Hermes are all active shareholders but do not offer products direct to the public.

Punish the defector

Continuing with the example of the free-rider problem and shareholder activism, there are a number of possible mechanisms available that could ‘punish the defector’ and reduce the incentive for fund management firms to free-ride. In the game theory framework, the point at which agents believe that the risk of not participating will exceed the benefits of free-riding will define the turning point from defection to collaboration. Ultimately, fund management firms rely on the popularity of their products and services with the public and the investing community. The agents with the most influence over fund management firms in a free-market environment are the investors or ‘buyers’ of their products. The investors or ‘buyers’ include both the general public (retail investors) and the professional investment community (wholesale investors) who invest a portion of their assets in particular product offerings. The challenge is therefore to introduce mechanisms that will act as a potential threat to these relations through the following three channels:

1. Retail investors. The first step is to wake the sleeping giant! Retail investors (individual investors) and their financial advisors need to be better informed and equipped to ask the right questions and to make informed judgements about their investments. The threat of fund management firms being judged and assessed against shareholder activism criteria could provide an incentive for fund management firms to change.
2. Wholesale investors. Trustee boards, in conjunction with their advisors, could mobilise their power over fund management firms in the way they select and retain their services, such as through the criteria used to assess and review their performance. Asking for full disclosure of voting practices and engagement outcomes is a first and basic step to incentivise fund management firms to become more active shareholders.
3. Government. Moral suasion and the threat of new regulatory changes could act as deterrents to free-riding. Mandatory disclosure and a public ‘naming and shaming’ of agents (preferably by a government or industry body to ensure independence) that clearly stand out as non-contributors to the efforts of the wider community could provide an incentive to become more active. Moreover, being seen as a laggard in the investment community and by relevant government agencies could be a risk in terms of reputation and future regulatory costs.

Underlying the preceding discussion is a belief that the presence and existence of free-riding does not mean that an efficient cooperative solution cannot evolve. The perceived legitimacy of shareholder activism in the eyes of the fund management industry would increase as more demand agents (on both the retail and wholesale side) express an interest in such practices. This process of adaptation in beliefs and priorities will now be considered within an evolutionary game theory context.

Evolutionary game theory and adaptive efficiency

Over the last 20 years the emphasis in game theory has shifted towards evolutionary models, in large part because of the frustration with the limitations of models based on an assumption of rationality (Samuleson, 2002). Evolutionary game theory encompasses a wide range of models with origins from biology, psychology and behavioural sciences, all of which are in large part concerned with how players adapt their behaviour over the course of repeated games or series of interactions²⁸.

Underpinning the essence of evolutionary models is a recognition that the world economic system is dynamic, as are the drivers of people's behaviour and the institutional constraints that they operate within. Indeed, North (1999) argued that to understand the workings of an economic system it is vital to recognise that conditions will change over time, and that the future cannot be predicted or extrapolated from the past. Groups that are most efficient at adapting to change will be the most prosperous and enduring over the long term. This so-called 'adaptive efficiency' condition is relevant both at the individual and institutional level.

This process of adaptation has been discussed in the context of an evolutionary stable strategy (ESS) by Maynard Smith (1982) on the subject of animal behaviour, and by Sugden (1989), Boyer and Orlean (1992) and Young (1996) on the subject of how conventions evolve. The notion of an ESS goes beyond traditional game theory in studying human behaviour, since it relaxes the assumption that individuals are always rational enough to work out optimal strategies by deductive reasoning but rather posits a lower order level of rationality whereby strategies may emerge as a result of imitation and trial and error.

²⁸ Some of the major works on evolutionary game theory include that by Fudenberg and Levine (1998), Mailath (1998), Samuelson (1997) and Young (1993).

Despite the seeming appeal of evolutionary game theory for the study of interacting agents, it is in its infancy as a theory and yet to prove its usefulness in terms of finding practical solutions to the problem of coordination (Samuelson, 2002:62). It is part of the growing body of literature associated with the notion of ‘bounded rationality’ whereby interacting agents are able (through a process of learning and imitation) to arrive at some estimate of their expected payoff from particular choices, as well as the payoff of interacting agents²⁹. The important message from the ESS approach to the study of pension funds and their agents is more about the framework for thinking about how the relationships between interacting agents evolve over time. It suggests that beliefs and priorities of interacting agents change and that this can alter perceptions of what is, or is not, in their self-interest. The implication of the evolutionary perspective is that pension funds and their agents need not be locked into a Pareto-inferior mode of behaviour indefinitely, but rather that collaboration could be indicative of adaptive efficiency amongst the collaborative agents. Evolutionary game theory has also supported a raft of important literature that further developed the evolution of cooperation (Axelrod, 1984) and the evolution of conventions (Schelling, 1960; Lewis, 1969; Sugden, 1986; and Young, 1996) that impact on interacting agents’ behaviour.

Evolution of cooperation

Axelrod (1984) proposed an evolutionary approach to cooperation, the principal tenet of which was to show that successful strategies are likely to be used again, whilst unsuccessful strategies will be abandoned. He uniquely introduced a time dimension to the study of cooperation and the apparent tension between short and long-term interests:

“The basic problem that Cooperation Theory addresses is the common tension between what is good for the individual actor in the short run, and what is good for the group in the long run.” (Axelrod, 2000:3)

Axelrod proposed three conditions that support the evolution of cooperation: firstly, that there are clusters of people with a sufficiently large chance of interacting again in the future; secondly,

²⁹ In the real world, estimates of a payoff function are difficult to arrive at. For example, many have found it difficult to measure and isolate the effectiveness (payoff) of shareholder activism as many factors contribute to company and portfolio performance. They are also unsure about the extent to which other agents in the market have benefited from shareholder activism. Despite the uncertainty in estimating payoffs, agents make choices and decisions and these are based on their judgement as to the likely net benefit.

that cooperation is based on reciprocity and trust; and finally, that stability in cooperation can be achieved when the ‘shadow of the future’ looms large.

Clusters of interacting agents. For cooperation to emerge in a world of unconditional defection, it is necessary that individuals interact with each other on a relatively frequent basis. Cooperation can evolve without friendship or foresight, as was demonstrated in the trench warfare practices of WWI where British and German soldiers cooperated through exploratory actions at the local level (Axelrod, 1984:73-83). This process started in small measures, such as not attacking enemy rations, and later evolved into a pattern of mutually understood behaviour ‘to live and let live’ through a process of trial and error and imitating the enemy’s behaviour. The high level of frequent interaction between investment agents in the financial market setting meets this condition and is vindicated by the large number of collaborative initiatives that have emerged over recent years.

Trust and Reciprocity. Axelrod argued that an important way to promote cooperation between interacting agents is trust and the principle of reciprocity; that agents mutually benefit from cooperation and believe they can trust in others to reciprocate their actions. This does not require individuals to be rational in the strict sense, but rather that they are equipped to collect information through a process of trial and error. The agents do not necessarily need to exchange words or communicate directly, as their behaviour will send the information signal that is required. In this way, “*no central authority is needed: cooperation based on reciprocity can be self-policing*” (Axelrod, 1984:174). Added to this, in situations of strategic collaborative initiatives, voluntary membership of alliances reduces the risk of defection (Axelrod, 1986:1105). The main challenge to the reciprocity principle for cooperation in the financial market setting is the lack of transparency in terms of individual agent behaviour, as the collective outcome is readily visible via the price determination process whilst the individual agent behaviour is less obvious.

Shadow of the future. This is the most important factor that will limit the risk of interacting agents pursuing their own short-term self-interest to the detriment of fulfilling the group’s long-term objectives. “*For cooperation to prove stable, the future must have a sufficiently large shadow,*” (Axelrod, 1984:174) meaning that the importance attached to future interactions between the agents must be high enough to present a disincentive to defect from cooperation.

This would tend to favour small group interactions where individuals would be held to account individually, or alternatively in a large group situation it necessitates transparency in terms of setting goals and measuring the effectiveness of the cooperative outcomes at the individual and group level. As Part II illustrated, many of the existing voluntary collaborative initiatives across the investment community have not created a sufficient ‘shadow of the future’ as they are lacking in terms of setting goals and evaluating the individual and group level outcomes.

Evolution of conventions

Conventions and norms are integral parts of the common ground shared by interacting agents. The pioneer on this subject is Schelling (1960; 1972), whose work on conflict and cooperation was awarded a Nobel Prize in Economic Sciences in 2005. He was concerned not only with the ability of individuals to coordinate their behaviour in situations of conflict, but also in situations without any strong conflict of interest but for which successful coordination would produce benefits for all parties. Schelling found that coordinative solutions, or focal points, could be arrived at more often than predicted by theory, and that coordination appears to be related to the parties’ common frame of reference. Indeed, Keynes’ beauty contest analogy and subsequent evidence in psychology and behavioural finance literature suggest that individuals have a strong tendency to conform to the accepted wisdom or belief of others. Such behaviour is due to a combination of automatic mimicry as agents learn from, and mimic, the behaviour of others³⁰ and a natural human tendency to conform³¹. In this way, interacting agents develop a common frame of reference as a means of managing the risks associated with decision making under uncertainty (Schelling, 1960).

This natural tendency to conform is good news for pension funds seeking collaborative solutions to the investment problems. Collaborative solutions are apparently easy to come by and have the potential to impact on investment agents’ frame of reference and day-to-day decision making. The key question is therefore how to identify what ‘collaborative solutions’ will redress the problems of short-termism and poor corporate and pension fund governance practices. That is, how can active collaboration help to modify the unhelpful coordinative solutions and encourage

³⁰ Shiller (1995), Grinblatt et al (1995) Sias and Starks (1997), De Bondt and Forbes (1999), Sias (2004) and Devenow and Welch (1996).

³¹ Asch (1952), Deutsch and Gerard (1955), Epley and Gilovich (1999) and Henrich and Boyd (1998).

the emergence of new ones? Whilst this requires purposeful actions on the part of interacting agents at the outset, the optimal solution in the long-run is to build new behavioural patterns into the pension fund management process so that it becomes self-sustaining and part of the day-to-day decision making process.

Building on Schelling's suggestion that some sort of magnetic force underpins the arrival at a solution in the coordination problem, Lewis (1969) defined this process as a 'convention'. Convention, Lewis went on to describe, represents a regularity in behaviour that is self-enforcing and mutually beneficial when all people within a group conform, such that individuals will conform on the basis that they expect everyone else in the group to conform.

"For me, a convention is a regularity in behaviour produced by a system of expectations.... I am concerned with cases in which we have both the regularity and the expectations..." (Lewis, 1969:118)

So in the context of pension funds and their agents, the practice of not participating in shareholder activism, poor internal governance practices and taking a short-termist, trading approach to investing are underpinned by prevailing 'conventions'. Building on this notion of conventions, the evolutionary theorists contend that conventions (and their inputs) are not static or permanent but rather they evolve over time (Young, 1996:106). It follows that through this evolution, conventions have the potential to become unstable when there are deviants within the group, whereby the greater the number of deviants, the greater will be the incentive for others not to conform and the conventions become unstable (Sugden, 1986). Choi (1999) described this in terms of the process of constant learning and adaptation that individuals undergo in response to observing the signals from the behaviour of others. This learning process, according to Choi, is not a rapid one but rather one that takes time. Nevertheless, the presence of deviants in itself challenges existing conventions and potentially introduces a new 'paradigm' or way of thinking (my bold):

"At any moment in a community, there is bound to be a number of people who have not quite learned to conform to conventions, or rather, who have adopted a different set of paradigms...Each deviant represents a new inference, **a new paradigm**, and a new way of doing things." (Choi, 1999:256)

The evolution of conventions via this process of learning and adaptation can emerge under different conditions (Boyer and Orlean, 1992:170), such as a result of:

1. A general collapse. Where the existing convention collapses in a very short period in response to some external shock or event;
2. External invasion. Where a new group adopts an alternative convention and creates instability in the existing convention;
3. Translation. Where a new convention becomes interspersed with an old convention, causing some transformation; and
4. Collective agreement. Where the group as a whole recognise the superiority of an alternative convention over the existing one, resulting in a deliberate and co-ordinated change in behaviour.

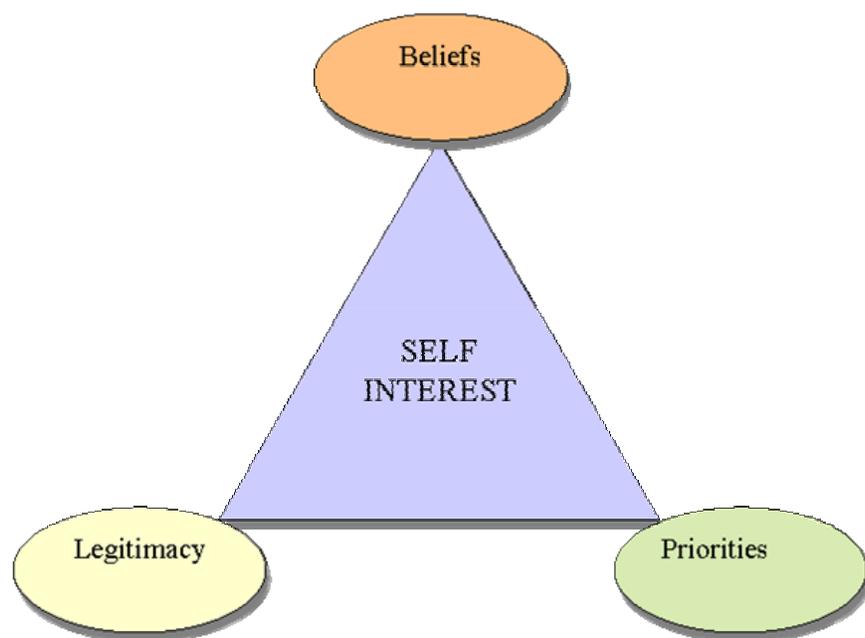
It is the latter condition – collective agreement – that is most relevant for considering the collaborative efforts of pension funds and their agents. As the case study evidence highlighted, perception of legitimacy is a key factor driving agents’ willingness (or not) to participate in collaborative initiatives. In the context of creating and sustaining new conventions and ‘norms’ of behaviour in the investment management process, legitimacy is one of the key factors that will contribute to the attractiveness and success of a collaborative initiative. This is particularly true for institutional investors operating in what is inherently a conservative industry bound by fiduciary obligations; as such, collective agreement, or collaboration, will often be preferable to going alone both from an efficiency and risk management perspective. In the context of this study, the key question is: What are the conventions that need to change and how can a collaborative framework help to accelerate this process of adaptation? That is, what do we want, and from whom?

A collaborative framework for changing conventions

Drawing from the literature and case studies reviewed thus far, it is reasonable to surmise that collaboration will prevail over conflict or individual action when agents believe that the benefits of collaboration will outweigh the costs. Collaboration is invariably targeted at the ‘harder to fix’ problems that exist at the industry-wide level, rather than being firm-specific issues. Often the activities require a rethink of the conventions that are commonly relied upon in day-to-day decision making by many different agents. Whilst heterogeneity presents a challenge for developing a framework for identifying and mobilising collaborative opportunities, it will be

argued that the key motives for collaboration can be reduced down to an assessment of consistency with an agent's pursuit of self interest, as determined by their beliefs, priorities and perception of legitimacy (Figure 5).

Figure 5: Motives for collaboration

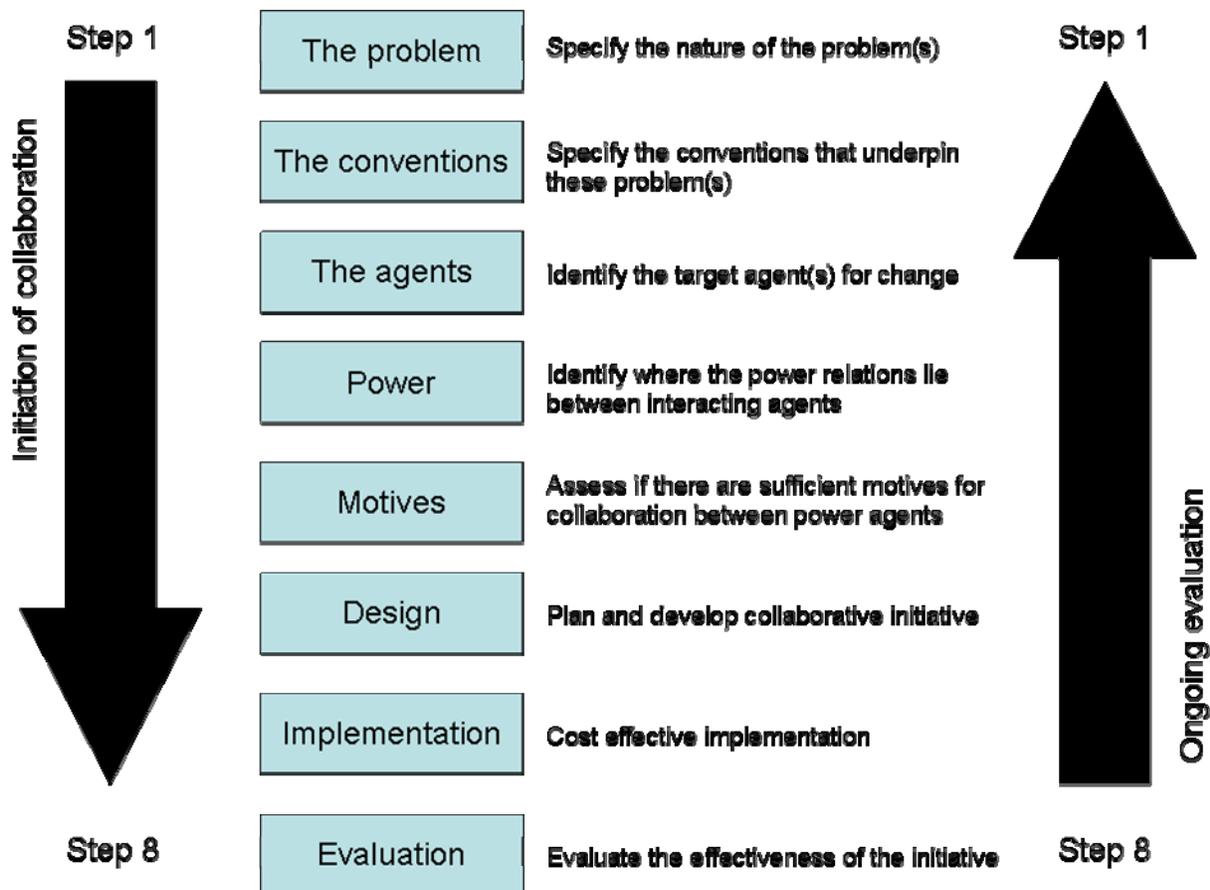


1. Pursuit of self-interest. The pursuit of self-interest is the primary motivator for each interacting agent in a group. Each agent brings with them a set of core goals and objectives that define the 'essence' of their role and functionality. Self-interest is a fixed motivator for agent behaviour, however the interpretation of self-interest is time varying and dependent on an agent's changing beliefs, priorities and perception of legitimacy;
2. Strength of beliefs. The degree to which agents believe that the issue of concern is valid and that collaboration will produce a net benefit for themselves and/or their representative institution will impact on the desirability of collaboration and the level of effort expended;
3. Priorities. Pension funds and investment institutions have competing goals and objectives with finite time and resources; hence higher priority issues are more likely to motivate agents to willingly engage in collaboration than lower priority issues; and

4. Trust and perception of legitimacy. Agents will be more willing to collaborate with others if they perceive the initiative to be legitimate, both in terms of the relevance and attainability of its objectives and the representation, trustworthiness and reputation of other members that it would be affiliated with.

The steps towards identifying and mobilising collaborative opportunities amongst interacting agents are summarised in Figure 6. The collaborative framework draws from the lessons learnt in the case study analyses and the insights gained from evolutionary game theory, coordination theory and conventions theory.

Figure 6: The collaborative framework



Each stage of the process will impact on the assessment as to whether collaboration is feasible for changing an agent's behaviour. Firstly, if the collaborative agents have only a weak influence over the target group then it may be necessary to develop strategies that indirectly target change in their behaviour (through mechanisms where they can exert influence and power). Secondly, if

the motivation for collaborative agents is weak, then it is unlikely that collaboration will provide a durable solution to change agent behaviour or redress the identified problems. All of these factors need to be evaluated before embarking on a collaborative endeavour. The good news is that as new practices/conventions emerge and become integrated into daily decision making, the need for explicit collaboration will dissipate and the costs incurred from such activities will diminish. Importantly, the process of evaluating the success of collaboration in Step 8 will involve an ongoing reassessment of the specified ‘problem’ as set out in Step 1. As the nature of the problem changes, the collaborative approach will also need to evolve and its efficacy re-evaluated; voilà adaptive efficiency!

The question as to who initiates a voluntary collaborative process is an interesting one, as many people are often too busy participating in their day-to-day responsibilities to notice that there might be a problem with the way a particular practice has developed at the industry level. The catalyst for fostering collaboration might come about from external influences (such as the government, lobby groups, academic research or due to changes in demand patterns) or internal influences (financial shortfalls, identified inefficiencies or due to shifting employee demands, beliefs and priorities). A group of concerned individuals might naturally emerge in the course of their daily interactions and jointly decide to collaborate in some way (e.g. the Enhanced Analytics Initiative), or it could be that an independent body acts as a champion for change through collaboration (e.g. the UN PRI). The Rotman ICPM and its Partners are well placed (in terms of influence and power over other market agents) to consider how collaboration might improve the pension fund management process.

Application of the collaborative framework

The problems

As outlined earlier, this report aims to identify how collaboration might help to redress the following three problems with the way institutional assets are invested:

1. Short-term investment horizon
2. Absence of shareholder activism
3. Poor pension fund governance practices

The conventions

The conventions that underpin short-termism, the absence of shareholder activism and poor pension fund governance structures are presented in Figure 7. This table draws from a number of sources and contributions on specifying the investment problem and its causes, including Bogle (2005) and Monks (2001) on the absence of shareholder activism; Myners (2001) and Ambachtsheer (2007) on poor pension fund governance; Davis et al (2006) on both of these factors; the CFA short-termism report (2006), Myners (2001) and Guyatt (2005; 2006) on short-termism amongst institutional investors.

Figure 7: The investment problems and conventions

Problem	Conventions
Short-termism	<ul style="list-style-type: none"> Narrow valuation framework Excessive focus on earnings Excessive focus on relative returns to asset-based index (rather than liability-based benchmarks) Short-term performance appraisal Short-term investment mandates
Absence of shareholder activism	<ul style="list-style-type: none"> Ill-specified board-level shareholder activism policy Lack of training and expertise re activism Weak participation in, and disclosure of, voting and engagement practices Low importance in fund manager selection/retention Low importance in criteria used for performance review
Poor pension fund governance	<ul style="list-style-type: none"> Poor accountability and transparency of board appointments Over-reliance on for-profit external agent advice Lack of investment knowledge, skill and experience of board of trustees Poor balance sheet risk management

The agents

There are many agents involved in the pension fund management process, the major ones are summarised below. A brief description of each agent is provided in approximate order of authority along the investment management chain, bearing in mind the important caveat that the relationships are by no means linear or static over time.

- Beneficiaries. Those individuals saving for a secure retirement future with the choice to invest either through a company pension scheme, an industry scheme or direct investments via a mutual fund;
- Trustees. Those with the fiduciary responsibility to design the policy and oversee the management of beneficiaries' savings according to their best interests;
- Fund executives. Those with responsibility for managing the pension plan scheme (the policy of which is determined by the board of trustees), be it a company plan, public pension fund or mutual fund;
- Actuaries. Provision of analysis and advice to the board of trustees on the funding position of the pension plan;
- Investment consultants. Provision of analysis, services and consulting advice to the board of trustees and fund executives on the policy design and ongoing management;
- Financial advisors. Provision of investment advice and secondary management services to individual beneficiaries on matters relating to their retirement savings plan;
- Fund managers. Investment management services and product offerings for pension plan assets, sometimes internally managed within pension plans or externally managed via external managers (or often a combination of both);
- Analysts. Investment analysis and buy/sell recommendations from within brokerage firms and pension fund firms to clients, including fund managers of pension fund assets;
- Rating agencies. Analysis and rating of companies for investors, including the general public (individual investors) and investment professionals (including analysts and fund managers of pension fund assets, consultants and financial advisors);
- Index constructors. Research and development of indexes and benchmarks used by trustees, consultants and fund managers in product development and the day-to-day management and evaluation of investment outcomes;
- Industry bodies. Representation and development of industry standards;

- Opinion leaders, media, think-tanks. Reporting and questioning of pension fund industry developments by high profile individuals, organisations (including NGOs), media articles and research reports;
- Government. Regulation and policy framework that impacts on pension fund organisations and their agents;
- Educators. Professional industry standards and accreditation requirements for pension fund organisations and their agents; and
- Academics. Research and critical evaluation of prevailing theories and evidence that relate to the pension fund management process, including through publications, collaborative research projects and conferences.

Continuing with the assessment of the investment problems and the conventions that prevail, the target agents for change in behaviour for each convention are summarised in Figure 8.

Figure 8: The investment problems, conventions and target agents

Problem #1	Conventions	Target agents
Short-termism	Narrow investment criteria	Analysts Fund managers Trustees Fund executives Rating agencies Index constructors
	Excessive focus on near-term earnings	Analysts Fund managers
	Excessive focus on relative returns to asset based index (rather than liability based benchmarks)	All agents
	Short-term performance appraisal	Consultants Trustees Fund executives Beneficiaries
	Short-term investment mandates	Consultants Trustees Fund executives

Problem #2	Conventions	Target agents
Absence of shareholder activism	Ill-specified board-level shareholder activism policy	Consultants Trustees
	Lack of training and expertise re activism	Trustees Fund executives Fund managers
	Weak participation in, and disclosure of, voting and engagement practices	All agents
	Low importance in fund manager selection/retention	Consultants Trustees Beneficiaries
	Low importance in criteria used for performance review	Consultants Trustees Beneficiaries
Problem #3	Conventions	Target agents
Poor pension fund governance	Poor accountability and transparency of board appointments	Corporations Government Industry bodies
	Over-reliance on for-profit external agent advice	Trustees Fund executives
	Lack of investment knowledge, skill and experience of board of trustees	Government Industry bodies Educators
	Poor balance sheet risk management	Actuaries Trustees Corporations

Power

Having identified the problems, the conventions associated with each problem and the target agents for change, we can now move on to consider the role of the ‘power agents.’ Figures 9, 10 and 11 outline the power agents that have some influence over the target agents and the nature of the relationship (be it a direct, contractual relationship or indirect) to redress the problems of short-termism, the absence of shareholder activism and poor pension fund governance standards. Columns 1 and 2 reiterate the conventions associated with the investment problem and the target agents for change; Columns 3 and 4 list the power agents and relationship between them and the target agents for change; and Column 5 lists what (if any) collaborative initiative already exists.

Figure 9: Short-termism

Conventions	Target agents	Power agents	Relationship	Collaboration
Narrow investment criteria	Analysts	Fund managers	Commission	EAI UN PRI
	Fund managers	Consultants Fund executives	Rating Bonus	
	Trustees Fund executives	Opinion leaders, media, think-tank	Communication and standards	
	Rating agencies	Clients	Product demand	
	Index constructors	Clients	Product demand	
Excessive focus on near-term earnings	Analysts	Fund managers	Commission	EAI
	Fund managers	Consultants Fund executives	Rating Bonus	
Excessive focus on relative returns to asset based index (rather than liability based benchmarks)	All agents	Industry bodies Government Educators Academics	Standards Regulation Standards Evidence	
Short-term performance appraisal	Consultants	Trustees	Contract	Marathon Club CFA CFMI ICPM
	Trustees	Consultants Government Fund executives Educators	Advice Regulation Communication Standards	
	Fund executives	Trustees Academics	Board policy Evidence	
	Beneficiaries	Fin. advisors Government Educators	Advice Regulation Knowledge	
Short-term investment mandates	Consultants	Trustees	Contract	Marathon Club CFA CFMI
	Trustees	Consultants Government Fund executives Educators	Advice Regulation Communication Standards	
	Fund executives	Trustees Academics	Board policy Evidence	

Figure 10: Absence of shareholder activism

Conventions	Target agents	Power agents	Relationship	Collaboration
Ill-specified board-level shareholder activism policy	Consultants Trustees	Trustees Consultants Government Fund executives Educators Academics	Contract Advice Regulation Communication Standards Evidence	GCGF CII, GCGF GCGF
Lack of training and expertise re activism	All agents	Industry bodies Government Educators Academics	Standards Regulation Standards Evidence	CII, ICGN, GCGF, UN PRI SHARE
Weak participation in, and disclosure of, voting and engagement practices	Trustees Fund executives Fund managers	Consultants Beneficiaries Government Educators Academics Industry bodies	Advice Demand Regulation Standards Evidence Standards	CFA NAPF, CII, ICGN CCGG, ACGA, ECGI GCGF
Low importance in fund manager selection/retention	Consultants Trustees Beneficiaries	Trustees Government Fund executives Educators Academics Consultants Government Fund executives Educators Academics Fin. advisors Government Educators	Contract Regulation Contract Standards Evidence Advice Regulation Communication Standards Evidence Advice Regulation Knowledge	
Low importance in criteria used for performance review	Consultants Trustees Beneficiaries	Trustees Consultants Government Fund executives Educators Academics Fin. advisors Government Educators	Contract Advice Regulation Communication Standards Evidence Advice Regulation Knowledge	

Figure 11: Poor pension fund governance

Conventions	Target agents	Power agents	Relationship	Collaboration
Poor accountability and transparency of board appointments	Corporations Government Industry bodies	Government Industry bodies Industry bodies Academics Members Government Opinion leaders, media, think-tank Academics	Regulation Standards Lobby Evidence Membership rights Regulation Communication and lobby Evidence	 ACPM ICPM ICPM
Over-reliance on for-profit external agent advice	Trustees Fund executives	Government Fund executives Educators Opinion leaders, media, think-tank Academics	Regulation Communication Standards Communication and lobby Evidence	I.P. Principles SHARE Myners Review
Lack of investment knowledge, skill and experience of board of trustees	Government Industry bodies Educators	Industry bodies Academics Members Government Opinion leaders, media, think-tank Academics Government Industry bodies	Lobby Evidence Membership rights Regulation Communication and lobby Evidence Regulation Lobby	NAPF, ACPM ICPM ICPM
Poor balance sheet risk management	Actuaries Trustees Corporations	Government Fund executives Industry bodies Educators Government Industry bodies Opinion leaders, media, think-tank	Regulation Communication Standards Standards Regulation Lobby Communication and lobby	 ICI, ACPM

As can be seen from Figures 9-11, the investment problems are complex and can be broken down into a number of conventional modes of behaviour that, in turn, are reinforced by many different agents along the investment management chain. A few of the existing initiatives reviewed in Part II address some of the problems and conventions identified, although many of these have been designed to target change in corporate agent behaviour, rather than investor agent behaviour (particularly the corporate governance, responsible investment and climate change initiatives). Consequently, the untapped potential for collaboration to redress specific problems with investment agent behaviour via contractual or indirect relations is significant.

On the question of short-termism (Figure 9), the Enhanced Analytics Initiative is a good example of power agents targeting the ‘problem’ agents, in this case the request from fund managers to analysts (via commission fees) that they widen the valuation framework to discourage excessive focus on near-term earnings. The education and academic groups are also rising in significance as indicated by a roundtable discussion sponsored by the CFA Centre for Financial Market Integrity on short-termism and the Rotman ICPM June 2006 workshop theme of long-horizon investing. The UN PRI has set about encouraging wider valuation metrics, whilst the Marathon Club is focused on lengthening the investment horizon and engaging with other asset owners in designing an alternative investment paradigm to the existing one. Despite these positive examples, the conventions that underpin short-termism remain intact and there are many agents that need to be targeted for change. In particular, there is a need to challenge the current practice of excessive focus on relative returns to asset based indexes rather than liabilities, short-term performance appraisal and short-term investment mandates as none of the existing collaborative initiatives directly target these issues.

Widespread participation in shareholder activism is needed across all pension fund agents for the industry to become an effective voice in the promotion of better corporate governance. As Figure 10 illustrates, the notable ‘positive’ examples of collaborative initiatives with this aim in mind include the CII that is targeted towards education and mobilisation of its members to exercise their voting proxy power and the smaller initiatives such as the Investment Protection Principles and the collaboration between CalPERS and Hermes. Many of the other existing initiatives are fragmented and regional in their approach, making it difficult for global investors to generate economies of scale from voting and engagement activities that span cross-border investments.

The development of international standards for disclosure and reporting of shareholder activism across all types of institutional investors in all the major markets would encourage wider participation and efficiency gains. Moreover, there is little apparent follow-through or effort to integrate shareholder activism into the criteria used to select, retain and evaluate fund manager performance. Collaborative initiatives that target specific power agents, such as trustees and consultants (for wholesale funds) and financial advisors and individuals (for retail funds) to take activism into account in their deliberations are worthy of further consideration.

Improving pension fund governance requires significant leadership and impetus from regulators, industry bodies, trustees, consultants, fund executives, educators and opinion leaders. This is the grey area that most collaborative arrangements reviewed in this report do not address, although the National Association of Pension Management, the Association of Canadian Pension Management and SHARE all support the advancement of good pension fund governance through education and lobbying government for regulatory change. The impetus for change and improvement to pension fund governance standards will likely need to be led by outsiders to the investment management process, as trustees and corporations have demonstrated little inclination to instigate change themselves (only to the extent that it might minimise any new regulatory burden).

Motives

Having identified the problems, target agents for change and power relations that exist between different agents, the next step is to examine whether the motivations exist amongst the ‘power’ agents to further exert their influence either independently or collaboratively. In some cases this might involve an extension of collaborative initiatives, a co-union between existing initiatives or the development of a new approach. The core motives of each agent in the investment management chain are summarised below and will be drawn from in Part IV when specific recommendations will be presented.

- Beneficiaries. Secure retirement future;
- Trustees. Minimise fiduciary risk;
- Fund executives. Build and maintain relations with the board of trustees and implement board policy;

- Actuaries. Generate fee revenue by building and sustaining client base;
- Investment consultants. Generate fee revenue by building and sustaining client base;
- Financial advisors. Generate fee revenue by building and sustaining client base;
- Fund managers. Generate fee revenue by building and sustaining asset base (at the firm level) and to maximise bonus payouts by outperforming a benchmark by a specified amount for a given year (at the individual level);
- Analysts. Maximise fee revenue by generating transactions (at the firm level) and maximise bonus payouts by producing buy/sell recommendations that generate financial market transactions (at the individual level);
- Rating agencies. Generate fee revenue through the sale of rating research reports and services;
- Index constructors. Generate fee revenue through the sale of benchmark data products and services;
- Industry bodies. To provide a credible and influential voice for its representatives;
- Opinion leaders, media, think-tanks. To be a credible and influential voice within the investment industry;
- Government. To review and create the appropriate regulatory framework for effective pension fund management;
- Educators. To educate and equip agents with the necessary investment knowledge and standards; and
- Academics. To extend and challenge existing investment theory and evidence.

Design and implementation

The key lessons from the review of the academic literature in terms of designing a collaborative initiative are the principles of reciprocity and to enlarge the shadow of the future (to encourage sustained collaboration). The power agents need to discuss the problem and possible solutions in order to agree on the highest priority areas, with clear goals set over the short, medium and long-

term. Any initiative will need to have a well-defined objective, where the collaborating agents are in agreement about the change being sought and the agents being targeted. The cost, level of effort and skill required will also need to be built into the design and implementation of any initiative.

Evaluation

The evolutionary framework highlighted the importance of evaluating the effectiveness of any collaborative effort, both in terms of its core objective and in response to new developments that evolve over time. The process of reviewing and adapting to change is important to ensure that the initiative stays on track, that it remains relevant, that agents sustain high levels of trust and that the ‘shadow of the future’ is enlarged by a circle of accountability than binds agents beyond their short-term pursuits. Drawing from the collaborative framework presented in this paper and Bardach (1998:115-162), the recommended steps for evaluating collaborative initiatives are to:

1. Measure, review and report on the progress against these goals to ensure that all Partners have a voice and a stake in the group’s success. The success measures should be based on a combination of qualitative factors (to assess the improvement in target agent behaviour) and quantitative factors (to assess the improvement in efficiency and performance);
2. Maintain momentum through ongoing interactions and re-assessment of the problem, the conventions and changes to target agent behaviour; and
3. Be flexible and responsive to improvements in target agent behaviour, including a long-term plan to scale down collaborative efforts as new conventions emerge.

Where to from here

Many collaborative initiatives amongst pension funds and their agents have emerged over recent years in an attempt to improve the workings of the market mechanism, most of which have been targeted at changing corporate, rather than investor behaviour. It has been argued that more consideration needs to be given to the development of collaborative initiatives that specifically target investor behaviour to overcome the problems of short-termism, absence of shareholder activism and poor pension fund governance standards. A systematic approach to collaboration is needed to ensure that any initiative is viable, well-targeted and transparent in terms of its goals and achievements over time. A theoretical framework has been developed and applied to identify

the conventions associated with each investment problem, the target agents for change, the power agents and their inter-relationships.

This analysis revealed that, despite the significant number of collaborative initiatives that have been established, there are many areas that remain overlooked. For example, whilst some initiatives have emerged to tackle short-termism, these still do not directly confront the problems of excessive reliance on asset-based benchmarks and the short-term criteria used to select and review fund manager performance. On the goal of increasing shareholder activism, a number of collaborative initiatives have emerged but these tend to be regional in focus and narrow in their membership base, with no effort to establish international collaboration and standards in shareholder activism. Finally, improving pension fund governance is the grey area that most collaborative arrangements fail to address and there is a need to mobilise regulators and industry bodies to develop better standards.

Part IV: Recommendations for the Rotman ICPM and its Partners

Scope and potential influence

This section presents recommendations as to what collaborative action the Rotman ICPM and its Partners might consider to help improve the pension fund management process. The Centre and its Partners represent the following agents:

1. Academia. Funding and development of new research and evidence to study the investment problems and contribute to the development of new solutions;
2. Opinion-leaders. Rotman ICPM is comprised of individuals with a strong reputation and high profile who have the potential to influence thinking amongst other agents in the fund management industry through their policies, practices and communication with others; and
3. Fund executives. The Partners represent senior members of global pension fund institutions who have influence over their internal fund processes and the agents along the investment management chain through the setting of fund manager bonuses, design of internal investment processes and through their interactions with trustees, investment consultants, fund managers and other investment agents.

The power and potential influence of Rotman ICPM spans many of the target agents involved in the pension fund management process, both directly through contractual relations (such as consultants and fund managers) and indirectly through the dissemination of their opinions, research, internal fund processes and communication with others. Participation in Rotman ICPM research and activities is a form of collaboration in itself and, as such, the recommendations suggest actions that each partner could take both individually, collaboratively (as the ‘Centre’) and through cooperation between the Centre and other agents along the investment management chain. The following recommendations summarise the information contained in Figures 9-11, highlighting the power agents’ sphere of influence as academics, opinion leaders and fund executives.

Lengthen the investment horizon

1. Narrow investment criteria and excessive focus on near-term earnings

Conventions	Target agents	ICPM Power agents	Relationship
Narrow investment criteria	Fund managers Analysts Consultants	Fund executives Academics Opinion leaders	Bonus Commission Communication and lobby

Action:

- Fund executives to ask fund managers to widen their investment criteria and to discourage excessive focus on near-term earnings by reviewing the mandate design and incentive system that reinforces a short-term, narrow framework.
- Fund executives that utilise external analyst research to either join the EAI, or encourage their fund managers to join and support new and ongoing research projects that expand the investment valuation framework.
- As opinion leaders, academics and fund executives, request investment consultants to build in wider metrics into their assessment of fund managers through direct and indirect communications.

2. Excessive focus on relative returns to asset-based indexes

Conventions	Target agents	ICPM Power agents	Relationship
Excessive focus on relative returns to asset based index (rather than liability based benchmarks)	All agents	Academics Opinion leaders	Evidence Lobby

Action:

- Encourage trustees, actuaries, investment consultants, fund managers, industry bodies and regulators to review existing benchmarks to consider alternatives to asset-based indexes through the dissemination of relevant research.
- Embark on new research and promote education of alternative benchmarks such as absolute return and liability-based benchmarks with a view to creating new industry standards.
- Collaborate with specialist research groups on liability driven investing.
- Collaborate with education bodies to better inform beneficiaries and their advisors on the dangers of excessive focus on short-term peer review assessments.

3. Short-term performance appraisal and investment mandates

Conventions	Target agents	ICPM Power agents	Relationship
Short-term performance appraisal	Trustees Fund executives	Fund executives Academics	Communication Evidence
Short-term investment mandates	Trustees Fund executives	Fund executives Academics	Communication Evidence

Action:

- Communicate to trustees, investment consultants and financial advisors the perils of short-term performance appraisal and the link to short-termism and high portfolio turnover.
- Develop and disseminate best practice standards in collaboration with investment consultants, industry groups and other academic institutions on the frequency of monitoring portfolio performance, the criteria used for assessment and the term of the investment mandate.
- Collaborate with education bodies to better inform beneficiaries and their advisors on the cost of high turnover.

Promote increased shareholder activism

4. Ill-specified board level policy

Conventions	Target agents	ICPM Power agents	Relationship
Ill-specified board-level shareholder activism policy	Consultants Trustees	Fund executives Academics Opinion leaders	Communication Evidence Lobby

Action:

- Through communication and evidence based arguments, encourage all trustees/pension fund boards to develop a clear board-level policy on shareholder activism.
- As opinion leaders, academics and fund executives, request investment consultants to reflect shareholder policy in mandate design, fund manager selection and fund manager review processes.
- Develop and disseminate best practice standards in liaison with educators, academics and industry bodies on shareholder policy design.
- Liaise with and lobby government regulators about mandatory disclosure of shareholder activism policy.

5. Lack of training and expertise

Conventions	Target agents	ICPM Power agents	Relationship
Lack of training and expertise re activism	Fund managers	Fund executives	Policy
	Analysts		
	Consultants	Academics	Evidence
	Trustees	Opinion leaders	Lobby

Action:

- Lobby education groups and industry bodies to review and integrate shareholder activism into accreditation in professional training and development courses, university courses and other professional training to newly qualified investment professionals.
- Introduce and lobby industry regulators for mandatory retraining of existing professionals, particularly analysts, fund managers, fund executives, consultants, trustees and financial advisors about the relative merit of shareholder activism.
- Produce a list of best practice standards for implementation of a shareholder activism policy.

6. Weak participation and disclosure of voting and engagement

Conventions	Target agents	ICPM Power agents	Relationship
Weak participation in, and disclosure of, voting and engagement practices	Trustees	Fund executives	Communication
	Fund managers		Bonus
	Consultants	Academics	Evidence
	Financial advisors	Opinion leaders	Lobby

Action:

- Fund executives join a regional collaborative initiative focused on shareholder activism and, as members, work towards building an international alliance.
- If not already in place, introduce disclosure of voting and engagement practices within respective institution.
- Work to create uniform, international standards for minimum disclosure requirements in conjunction with industry representatives and regulators.
- Lobby and work with regulators for mandatory disclosure and reporting of voting and engagement activities for all asset owners and fund management firms.
- Bolster and disseminate academic research and evidence of the implications of shareholder activism for firm and portfolio performance.
- Build best practice case study examples and disseminate these via academic research and public communication to target trustees, consultants and financial advisors.

7. Low importance in fund manager selection and performance review

Conventions	Target agents	ICPM Power agents	Relationship
Low importance in fund manager selection and performance review	Consultants Rating agencies Financial advisors Beneficiaries	Fund executives Academics Opinion leaders	Communication Evidence Standards

Action:

- Request that consultants integrate evidence of shareholder activism into the rating, selection and review of fund managers.
- Encourage rating agencies and financial advisors to build shareholder activism criteria into their rating and evaluation of retail funds for individual investors.
- Lobby and work with educators to better educate beneficiaries and their advisors on the importance of voting and engagement activities for long-term portfolio performance and risk management.

Promote better pension fund governance

8. Poor accountability and transparency of board appointments

Conventions	Target agents	ICPM Power agents	Relationship
Poor accountability and transparency of board appointments	Trustees Government Industry bodies	Fund executives Opinion leaders Academics	Policy Communication Evidence

Action:

- Fund executives to review existing policy of trustee/governing board appointment procedures within respective institution and/or transfer knowledge to others.
- Lobby regulators to introduce higher standards and transparency in the appointment of independent board members for all asset owners to protect against conflict of interest.
- Work to create international standards of accountability in trustee appointments based on principles of meritocracy in collaboration with industry groups or an appropriate independent organisation (such as the UN, OECD or WEF).

9. Over-reliance on for-profit external agent advice

Conventions	Target agents	ICPM Power agents	Relationship
Over-reliance on for-profit external agent advice	Trustees Fund executives	Fund executives Opinion leaders Academics	Communication Standards Evidence

Action:

- Fund executives to review pension fund governance policy and utilisation of internal expertise versus external advice. Share experiences where reforms have already been made.
- Consider developing a not-for-profit ‘pension fund governance’ collaborative initiative in conjunction with other academics, trustees, pension fund executives, regulators, industry bodies and international organisations.
- Conduct research and disseminate best practice standards for pension fund governance across all fund management firm types.

10. Lack of investment knowledge of board members

Conventions	Target agents	ICPM Power agents	Relationship
Lack of investment knowledge, skill and experience of board of trustees	Government Industry bodies Educators	Academics Opinion leaders	Evidence Communication and lobby

Action:

- Through a ‘pension fund governance’ initiative, develop and disseminate board member selection criteria that stipulate a minimum level of investment knowledge and competency based on an assessment of academic qualifications, relevant work experience and/or industry training.
- Introduce and lobby industry regulators for mandatory training of existing board members in conjunction with international industry educators (such as the CFA in the US, IMRO and FSA in the UK, ASFA in Australia).

11. Poor balance sheet risk management

Conventions	Target agents	ICPM Power agents	Relationship
Poor balance sheet risk management	Actuaries Consultants Trustees	Fund executives Academics Opinion leaders	Process Evidence Communication and lobby

Action:

- As fund executives, academics and opinion leaders, encourage the board of trustees to unify the management of assets and liabilities across the pension plan (or where this has already been implemented, share with others as to the techniques and processes).
- As fund executives, if not already in place, request that actuaries value liabilities over regular intervals based on different assumptions and current yields³².
- As fund executives, request that consultants and actuaries consider how investment mandates can be better defined to align with pension plan liabilities. Where this has already been implemented, share experiences with others.
- Collaborate with regulators via the ‘pension fund governance’ initiative to find solutions to prevent balance sheet management issues from interfering with investment decisions.

Conclusion

There are many options to consider in terms of initiating a new collaborative initiative and/or participating in existing ones. Some of the recommendations listed above are directed towards fund executives in their role as influential individuals within a particular investment institution, as well as being powerful advocates for the wider investment community through sharing their experiences and the development of best practice standards. ICPM is well positioned to advance academic research, promote thought leadership and to disseminate best practice standards to the wider industry. Many of the recommendations can be implemented without any new processes beyond ICPM’s current collaborative mandate; rather it necessitates a formalisation of the role and responsibilities of the Centre and its Partners with specific goals and deliverables to help improve the pension fund management process. A questionnaire has been disseminated to assist in these deliberations, the results of which will be presented and discussed at the Rotman ICPM Workshop in June 2007.

³² This recommendation was proposed by Ambachtsheer, 2007:98.

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Appendix 1: Corporate governance initiatives

Country	Name	Objectives/function	Member profile	Fee
US	<p>Council of Institutional Investors</p> <p>Not for profit organisation</p> <p>www.cii.org</p> <p>Founded in 1985 with 21 members, it now has 140 members including public, union and corporate pension funds with \$3tr AUM</p>	<p>Shareholder rights organisation</p> <p>Education and exercise of proxy votes on CG issues</p> <p>Encourages member funds to use their proxy votes, shareholder resolutions, pressure on regulators, discussions with companies, and, when necessary, litigation to protect plan assets</p>	<p>US pension funds including employee benefit plans, (state and local agencies), not-for-profit endowments and foundations</p> <p>Other members include international participants and educational sustainers</p>	<p>Pension plan members: US\$1.30 per \$1 million in fund assets, but no less than US\$3,000 and no more than US\$30,000</p> <p>International participants' annual dues US\$2,500</p> <p>Educational sustainers US\$7,000 for companies with less than 25 employees and US\$10,000 with 25 or more employees</p>
Global	<p>International Corporate Governance Network</p> <p>Not for profit organisation</p> <p>www.icgn.org</p> <p>Formed in 1995, it reportedly has 400 members, predominantly US and European based with increasing membership from Asia</p>	<p>Network for the exchange of views and information about international CG principles and practices, including the development and adherence to CG standards and guidelines</p> <p>Make representations to international bodies such as the OECD, the EC and the World Bank on policies related to CG</p>	<p>Any individual or organisation involved in the practice and theory of CG</p> <p>Predominantly institutional investors (representing \$10tr AUM), investment consultants, SRI and CG specialists and related service providers</p>	<p>In 2006, flat fee for all individual members or organisations of £223.25</p>

Country	Name	Objectives/function	Member profile	Fee
CAN	<p>Canadian Coalition for Good Governance</p> <p>Not for profit organisation</p> <p>www.ccgga.ca</p> <p>Formed in 2002 with 16 full members and 25 associates with \$350bn AUM</p> <p>Membership as at Jul 2006 was 47 with \$950bn AUM</p>	<p>To represent Canadian institutional shareholders in the promotion of CG practices that best align the interests of boards and management with those of the shareholder</p>	<p>Full membership of pension plans, investment advisors or mutual fund managers that vote proxies directly or indirectly in Canadian listed companies</p> <p>Associate membership for those wanting to observe the Coalition's activities for a period before becoming a full member</p>	<p>Full membership CAD\$4,500 with AUM below CAD\$3.5bn. Above this, the fee increases in increments of \$1,260 for every \$1bn in AUM to a maximum annual fee of CAD\$31,500</p> <p>Annual fees CAD\$5,000 per associate membership</p>
ASIA	<p>Asian Corporate Governance Association</p> <p>Not for profit organisation</p> <p>www.acga-asia.org</p> <p>Founded in late 1999 by Lombard/APIC, in cooperation with a board of investors and Asian professionals</p> <p>Membership as at Oct 2006 was a total of 56</p>	<p>Work with investors, companies and regulators in the implementation of corporate governance practices throughout Asia</p> <p>Primary activities include research, advocacy and engagement (regulatory issues only not direct engagement/voting on corporation conduct) and education</p>	<p>Membership is only open to corporations. Over 50 international members ranging from companies, pension funds, investment management firms, investment consultants and service providers</p> <p>Not open to government bodies, market regulators or organisations primarily funded by them</p>	<p>Core membership US\$2,500 per year: 5 nominated "contact persons"</p> <p>Premium membership US\$5,000 per year: 10 nominated "contact persons"</p>

Country	Name	Objectives/function	Member profile	Fee
EUR	<p>European Corporate Governance Institute</p> <p>Not for profit association</p> <p>www.ecgi.org</p> <p>Founded in 2002 with 24 members</p> <p>Membership as at Oct 2006 was 364, of which: 184 academics; 86 researchers; 65 institutional; and 209 ordinary members</p>	<p>Primary role is to undertake, commission and disseminate scientific research on corporate governance</p> <p>Based upon impartial and objective research and the collective knowledge of members, the ECGI can advise on the formulation of CG policy and development of best practice in Europe</p> <p>Close links with all institutional members and groups such as ICGN and GCGF</p>	<p>4 categories of membership:</p> <p>Academics</p> <p>Institutions, including European and international companies, institutions and enterprises</p> <p>Ordinary, namely those that wish to join as individuals</p> <p>Research members, who have been appointed Fellows or Research Assoc by the ECGI</p>	<p>The academic membership subscription is €100 pa</p> <p>The institutional membership subscription is €2,000 pa</p> <p>The ordinary membership subscription is €100 pa</p> <p>Research membership, which is for the duration of their appointment, is free</p>
Global	<p>Global Corporate Governance Forum</p> <p>Multi-donor trust fund</p> <p>www.gcgf.org</p> <p>Founded in 2001 by the World Bank Group and the Organisation for Economic Co-operation and Development (OECD)</p> <p>Projected to run until June 2007</p>	<p>To promote global, regional, and local initiatives that aim to improve the institutional framework and practices of CG</p> <p>Its key functions are to:</p> <p>Raise awareness and build consensus for implementation of reform</p> <p>Support institution and capacity building and provide technical assistance</p> <p>Support research relevant to the needs of developing countries</p> <p>Disseminate best practice materials and guidelines</p>	<p>Based in the joint IFC/World Bank Corporate Governance Department</p> <p>Plays a coordinating role among Donors, Founders and other relevant institutions</p> <p>Advised by the Private Sector Advisory Group comprised of leaders on CG reform, relevant country or regional experience and expertise which contributes to the knowledge base of the group</p>	<p>Funded by donor contributions</p> <p>Donations are accepted from governments, bilateral donors, international financial institutions and agencies</p> <p>Donations from NGOs and private bodies or individuals may also be accepted subject to approval</p> <p>Annual minimum donor contribution is US\$250,000 (IDA eligible countries minimum donor contribution is \$125,000)</p>

Appendix 2: Small group institutional investor initiatives

Country	Name	Objectives	Activities
UK	Marathon Club	<p>The overall goal is to stimulate pension funds, endowments and other institutional investors and their agents to be more long-term in their thinking and actions</p> <p>Behave as responsible and active owners with a view to increasing knowledge about how investment strategy and processes can improve the long term financial and qualitative buying power of fund beneficiaries</p> <p>www.marathonclub.co.uk</p>	<p>Promote the principles of Long-Term Long-Only (LTLO) investment</p> <p>Conduct consultation exercises with the pensions industry</p> <p>Produce discussion documents and consultation papers</p>
Global	<p>Enhanced Analytics Initiative</p> <p>Established in October 2004</p> <p>The Initiative represented total assets under management of €1.3 trillion as at Dec 2006</p>	<p>The EAI is an international collaboration between asset owners and asset managers aimed at encouraging better investment research, in particular research that take account of the impact of extra-financial issues on long-term investment</p> <p>Institutional investors and asset managers allocate individually at least 5% of their brokerage commissions to extra-financial research</p> <p>www.enhancedanalytics.com</p>	<p>The 5% commission is allocated individually by each EAI member organisation on the basis of a formal evaluation of extra-financial research reports</p> <p>The evaluation is conducted by an independent consultancy who acts as a neutral agent on behalf of EAI members</p>
US/UK	CalPERS and Hermes	<p>Joined forces to enhance shareholder value in the US and UK by campaigning for better corporate governance</p> <p>The transcontinental global alliance is designed to enhance the value of investments by actively exercising shareholder rights</p> <p>www.calpers-governance.org/principles/international/hermes/agreement.asp</p>	<p>Endorsement of respective proxy voting activities</p> <p>Consultation as to whether cooperative action is needed</p> <p>Cooperation on engagement and shareholder action</p> <p>Expansion of alliance to other countries when mutually agreed</p>

Country	Name	Objectives	Activities
US	Investment Protection Principles 3 US state pension funds, namely: North Carolina PERS, New York State Common Retirement Fund and State Treasurer of California	Development and ratification of the Investment Protection Principles, whereby every financial organization that provides investment banking services and is retained or utilized by the 3 funds must abide by a set of principles www.nasra.org/resources/investorprotectionprinciples.pdf	Require current and potential money managers to report on any potential conflict of interest, including: remuneration of portfolio managers and analysts; research recommendations and changes in coverage of companies; disclosure of compensation received from the companies researched; and implementation of a monitoring system to ensure compliance with the principles

Appendix 3: Industry body, semi-government and NGO initiatives

Country	Name	Objectives/function	Member profile	Funding source
US	<p>Investment Company Institute</p> <p>National association of US investment companies</p> <p>www.ici.org</p> <p>Formed in 1940, membership as at October 1, 2006 included 8,821 mutual funds, 654 closed-end funds, 234 exchange-traded funds, and 4 sponsors of unit investment trusts</p>	<p>Three core missions:</p> <p>Encourage adherence to high ethical standards by all industry participants</p> <p>Advance the interests of funds, their shareholders, directors, and investment advisers</p> <p>Promote public understanding of mutual funds and other investment companies</p>	<p>Membership is available to any SEC-registered investment company (open-end or closed-end), its investment adviser, and its underwriter</p> <p>Mutual fund members serve 89.5 million individual shareholders and manage \$9.5 trillion in investor assets</p>	<p>Membership fee is the primary source of income</p> <p>Additional sources are investment income, royalty income, program income, conferences and other self-funded sources of income</p>
UK	<p>National Association of Pension Funds</p> <p>www.napf.co.uk</p> <p>Formed in 1923, it reportedly has 1300 members that provide pensions for over 10m current employees and 5m people in retirement, and account for more than around £800 bn of pension fund assets</p> <p>Members include both large and small companies, multi-employer schemes, local authority and public sector bodies</p>	<p>Provides representation and other services for those involved in designing, operating, advising and investing in all aspects of pensions and other retirement provision</p> <p>These services are supplied through updates and publications, training courses, and conferences and exhibitions</p> <p>Lobbies parliament through submissions at both official and Ministerial level</p> <p>Media contacts and liaison with opinion formers, regulators and think tank organisations</p>	<p>All scheme types are covered including defined benefit, defined contribution, group personal pensions and statutory schemes such as those in local government</p> <p>Membership is open to companies, firms, local authorities and other organisations which provide pensions for their employees, industry-wide pension schemes and the trustee bodies associated with such pension funds</p>	<p>Fund membership for companies, local authorities & organisations providing pensions for their employees. Sliding scale cost up to max £3,212.45pa</p> <p>Business membership for those providing professional services to employer-sponsored retirement funds. Size based fee up to £6,756.25pa</p>

Country	Name	Objectives/function	Member profile	Funding source
CAN	<p>Association of Canadian Pension Management</p> <p>Not for profit organisation</p> <p>www.acpm.com</p> <p>Formed in 1976, as at July 2006 the ACPM had approximately 700 individual members and 25 institutional members</p>	<p>It advocates policies and activities which promote the growth and health of pensions in Canada based on the following 3 principles:</p> <p>Clarity in pension legislation, regulation and arrangements</p> <p>Good governance and administration</p> <p>Balanced consideration of stakeholder interests</p> <p>National conferences, events and regional events</p>	<p>Two categories of membership, individual and institutional</p> <p>Many individual members represent plan sponsors and other stakeholders, as administrators or plan trustees, or as consultants, investment managers, custodians and providers of other professional services (as well as government, academia & citizens)</p>	<p>Current annual membership dues (2006) in the Individual category are \$455 (CDN)</p> <p>There are two categories of Institutional Membership: Supporting (CAD \$5,000) and Leadership (CAD \$10,000)</p>
EUR	<p>European Fund and Asset Management Association</p> <p>Not for profit organisation</p> <p>www.efama.org</p> <p>Formed in 2001 (previously FEFSI), with over 40 corporate members as at Oct 2006 and, through affiliations, representation of over EUR 14tr AUM through over 46,000 investment funds</p>	<p>To represent the European investment management industry with authorities, regulators and other policy makers and opinion formers</p> <p>To promote and endorse effective self regulation</p> <p>To develop good relations with the media and public inside and outside Europe</p> <p>To develop accepted industry-wide operational standards and best practices</p> <p>To compile and disseminate industry data</p>	<p>Member associations from 19 EU Member States, Liechtenstein, Norway, Switzerland and Turkey</p> <p>40 corporate asset management members</p>	<p>Fees collected from member associations and corporate members, although details not publicly available</p>

Country	Name	Objectives/function	Member profile	Funding source
AUS	<p>Association of Superannuation Funds Australia</p> <p>Not for profit organisations</p> <p>www.superannuation.asn.au</p> <p>As at July 2006, over 200 members that collectively represent approximately 80% of total Australian superannuation assets</p>	<p>Protect, promote and advance the interests of superannuation funds, trustees and members</p> <p>Undertake research and develop policy to improve administration of superannuation and retirement income</p> <p>Create a public awareness of superannuation issues</p> <p>Provide professional development, education and training</p> <p>Promote best practice in the operation of superannuation funds</p> <p>Coordinate events, seminars and forums for information sharing, debate and networking</p>	<p>Members include corporate funds (30), industry funds (71), public sector funds (18), retail funds (15), service providers (58) (including custodians, administration providers, merchant banks, investment managers, life offices, accountancy and legal firms, actuaries) and individual membership (with a professional interest in superannuation)</p>	<p>Membership scale up to maximum of A\$25,000pa.</p> <p>Individuals at A\$495 pa with restricted access to research</p>
Global	<p>Chartered Financial Analyst (CFA) Institute</p> <p>www.cfainstitute.org</p> <p>Not for profit organisation</p> <p>Founded in 1947 called the National Federation of Financial Analysts Societies</p> <p>The name was shortened to the Financial Analysts Federation, or FAF. In 1990, the FAF merged with the Institute of Chartered Financial Analysts to form AIMR, which is now CFA Institute</p>	<p>Setting standards of ethics, education and professional excellence</p> <p>CFA Program – standard for measuring the competence and integrity of investment professionals</p> <p>Conferences – annual, ad-hoc, workshops, executive education, web and podcasts</p> <p>Publications – around 12 publications and other education resources, e.g. FAJ, the CFA Magazine and CFA Digest</p> <p>CIPM program – education for performance evaluation professionals</p>	<p>Member Count: 88,371</p> <p>Member Country 129</p> <p>Society Count 134</p> <p>Society Country Count 55</p> <p>Buy-side institutional investors account for 49% members (26% mutual funds; 15% banks; 5% inv companies; 3% pensions and foundations)</p> <p>Investment managers and advisors (12%); investment consultants (7%)</p> <p>Sell-side brokerage firms and inv banks (18%), with remainder classified as ‘other’</p>	<p>2 packages both at \$US225 pa</p> <p>Standard includes print editions of the FAJ, CFA Magazine, conference proceedings, CFA Digest and access to online CFA Institute publications</p> <p>Total access includes print editions of the FAJ and CFA Magazine and access to CFA Institute online publications and access to webcasts</p>

Appendix 4: Climate change initiatives

Country	Name	Objectives/function	Member profile	Funding source
UK	<p>Carbon Disclosure Project</p> <p>Not for profit charity</p> <p>Launched in Dec 2000 with 35 signatories to CD1, 95 to CD2, 155 to CD3 and 225 to CD4</p>	<p>Institutional investor collaboration on the business implications of climate change</p> <p>Institutional investors collectively sign a single global request for disclosure of information on Greenhouse Gas Emissions</p> <p>In 2006 CDP sent this request to 2180 companies, with over 950 responding with an answered questionnaire</p> <p>Responses are publicly available, free of charge, on the CDP website</p> <p>www.cdproject.net</p>	<p>Global institutional investors, including asset managers, pension funds, insurance funds, charities</p> <p>The CDP Secretariat works with the Global Reporting Initiative (GRI) in an effort to align the indicators and data as much as possible</p> <p>CDP works with the World Economic Forum GHG Registry</p>	<p>A special project of Rockefeller Philanthropy Advisers</p> <p>Funded by Esmée Fairbairn Foundation, The Nathan Cummings Foundation, Polden Puckham Charitable Foundation, Rufus Leonard, The Department for Environment, Food and Rural Affairs, The Marmot Charitable Trust and WWF-UK</p>
US	<p>Ceres</p> <p>Not for profit organisation</p> <p>Formed in 1989 with a select group of companies that made public commitments to stakeholder engagement, public disclosure, and performance improvements. Now a 85-member coalition and 70-plus partner companies</p>	<p>Coalition of investor groups, environmental organizations and investment funds consider environmental factors in investment decisions</p> <p>The coalition engages directly with companies on environmental and social issues</p> <p>Underpinned by a ten-point code of corporate environmental conduct and wider application of the GRI launched in 1997</p> <p>Conferences, workshops, policy dialogues and seminars, as well as dialogue with companies that are considering becoming Ceres companies</p>	<p>Includes partnerships with businesses, investors, and advocacy organizations committed to sustainability, including local, national or international</p> <p>Membership divided into environmental and public interest organisations (two-thirds) and investors and foundations (one-third)</p> <p>www.ceres.org/coalitionandcompanies</p>	<p>Membership fees vary from \$50 to \$2,000, depending upon the size and type (non-profit, grant-making, or investment firm) of the organisation</p> <p>New coalition members are approved by the Ceres board of directors</p>

Country	Name	Objectives/function	Member profile	Funding source
US/EUR	<p>Investor Network on Climate Risk</p> <p>Co-ordinated by Ceres</p> <p>Launched in November 2003 with 10 members, it now includes more than 50 institutional investors with over \$3 trillion AUM</p>	<p>Supports and coordinates its members' engagement with their portfolio companies and policy makers on climate risks and potential business opportunities</p> <p>Engage with companies vulnerable to the physical risks of climate change, such as insurers and real estate investment managers</p> <p>Participate in dialogues with companies in key carbon-emitting sectors, including electric power and oil & gas, which face regulatory risks</p> <p>Promote sustainability reporting through the adoption of GRI by US companies</p> <p>www.incr.com</p>	<p>Global institutional investors and financial institutions interested in learning about climate risk</p> <p>Participate in INCR meetings and working groups</p>	<p>Program co-ordinated by Ceres (see above)</p>
UK	<p>Institutional Investors Group on Climate Change</p> <p>Formed in 2003 and since 2005 it has been run as an independent programme of the NGO The Climate Group (TCG). It currently has 31 members</p>	<p>Forum for collaboration between pension funds and other institutional investors on issues related to climate change</p> <p>Promote better understanding of the implications of climate change</p> <p>Encourage companies and markets in which IIGCC members invest to address any material risks and opportunities to their businesses associated with climate change and a shift to a lower carbon economy</p> <p>www.iigcc.org</p>	<p>Membership open to any institutional investor (from the UK or elsewhere) that supports the aims and positioning of the IIGCC and is willing to attend one full member meeting per year and be involved in at least one IIGCC Workstream</p>	<p>Fee scale based on size of AUM up to a maximum of £3,500 pa</p>

Country	Name	Objectives/function	Member profile	Funding source
AUS/NZ	<p>Investors Group on Climate Change</p> <p>16 members with A\$200 bn AUM</p>	<p>The IGCC aims to ensure that the risks and opportunities associated with climate change are incorporated into investment decisions for the ultimate benefit of individual investors</p> <p>Raise awareness of the potential impacts resulting from climate change to the investment industry, corporate, government and community sectors</p> <p>Encourage best practice to include the impact of climate change into investment analysis</p> <p>Provide information to assist the investment industry to understand and incorporate climate change into the investment decision</p> <p>www.igcc.org.au</p>	<p>Membership open to Australian and New Zealand based investors interested in the impact of climate change on investments including superannuation funds, insurance companies, fund managers and other financial services providers (asset consultants, brokers, and investment industry associations)</p> <p>Options to join as Full member, Associate member, Funding partner or Supporter</p>	<p>Support of the EPA Victoria</p> <p>Associated with the IIGCC and the INCR</p> <p>Full member based on AUM up to a maximum of A\$8,000 pa</p> <p>Associate member fee A\$1500 for companies and \$0 for industry associations</p> <p>Funding partners A\$25,000 minimum</p> <p>Supporter fees A\$1,500</p>

Appendix 5: Responsible investment initiatives

Country	Name	Objectives/function	Member profile	Funding source
Global	<p>UN Principles for Responsible Investment</p> <p>www.unpri.org</p> <p>Representing over USD 4tr AUM as at Feb 2007</p>	<p>Development of a voluntary framework to assist institutional investors and their agents in the consideration of the Environmental, Social and corporate Governance (ESG) influences on the performance of investment portfolios and fiduciary obligations</p> <p>Phase 1 was the development phase of the principles, with Phase 2 focusing on the adoption by new signatories, as well as implementation and collaboration amongst existing and new signatories</p>	<p>Membership is divided into 3 categories</p> <p>Asset owners: around 55 members</p> <p>Investment managers: around 50 members</p> <p>Professional service partners: over 30 members</p>	<p>Coordinated and administered by UNEP FI and the UN Global Compact</p> <p>No compulsory fee, although there is a suggested (but voluntary) fee of USD \$5,000-10,000 to help the work of the secretariat in supporting signatories and promoting the Principles</p>
UK	<p>UKSIF</p> <p>www.uksif.org</p> <p>Launched in 1991 it had 250+ members and affiliates as at Dec 2006</p> <p>Primary purpose is to promote and encourage the development and positive impact of SRI amongst UK based investors</p>	<p>Inform, educate and provide a forum for discussion about SRI</p> <p>Promote understanding and development of SRI practices</p> <p>Identify, encourage and develop working models that demonstrate the effectiveness of SRI</p> <p>Support and encourage social accountability amongst investors</p> <p>Encourage and expect high ethical standards from members and the public</p> <p>Initiate and publish research for changes in legislation and company policies</p> <p>Promote co-operation with European and international SRI organisations</p>	<p>Members are UK based and include retail and institutional fund managers, financial advisers, SRI research providers, consultants, trade unions, banks, building societies, community development finance institutions, NGOs and individuals interested in SRI</p>	<p>3 membership categories: members, premium members; or affiliates</p> <p>Fees vary by category depending on AUM with Banks/fund managers ranging from £900-5000 pa; Professional ranging from £100-1500 pa; Pension funds, charities and others £100-900 pa; and Individuals £40</p>

Country	Name	Objectives/function	Member profile	Funding source
EUR	<p>Eurosif</p> <p>www.eurosif.org</p> <p>A not-for-profit entity that represents assets totalling over €600bn through its pan-European affiliate membership</p>	<p>Eurosif is a pan-European group whose mission is to address sustainability through financial markets</p> <p>Focus on helping members promote and network. Four main activities include: EU Lobbying to represent membership's views; Research on legislation, policies and practices for the integration of social, environmental, ethical and governance issues; Initiatives such as pension fund collaboration, trustee education and guideline development; and Events/Communications: 6 events per year on the state of SRI across Europe as well as invitations to international events</p>	<p>Members are made up of the national Social Investment Forums.</p> <p>The SIF members include France, Germany, Italy, Netherlands, the UK and Belgium</p>	<p>3 categories of annual membership fees:</p> <p>Financial Institutions 5,000 euros for SIF members and 7,500 euros non-members</p> <p>SRI Service Providers 2,500 euros SIF members and 3,750 euros non-members</p> <p>Not-for-profits (NGOs, Trade Unions, etc) 1,000 euros SIF members and 1,500 euros non-members</p>
CAN	<p>Social Investment Organisation</p> <p>Established in 1989, it is the national non-profit association for the socially responsible investment industry in Canada with over 400 Canadian based members</p> <p>www.socialinvestment.ca</p>	<p>The mandate is to:</p> <p>Take a leadership role in furthering the use of social and environmental criteria within the investment community in Canada</p> <p>Raise public awareness of socially responsible investment</p> <p>Establish the case for environmental/social analysis with other investment organizations</p> <p>Provide a forum and information source on socially responsible investment for members and the public</p>	<p>Members include:</p> <p>SRI mutual funds; Financial institutions; Investment advisors, managers and consultants; Institutions investing according to SRI guidelines; Retail investors investing according to SRI guidelines; NGOs and other groups with an interest in responsible investment</p>	<p>It is funded primarily from membership dues, where Financial advisors pay a professional membership fee of CAD\$300 pa; Organisations (including NGOs, charities and associations) pay CAD\$250 pa; and Individual investors pay CAD\$45 pa</p>

Country	Name	Objectives/function	Member profile	Funding source
US	<p>Social Investment Forum (Foundation and Ltd)</p> <p>The foundation is a national non-profit organisation and the Ltd is a non-profit membership association</p> <p>www.socialinvest.org/</p>	<p>The SIF Foundation aims to provide research and education on socially responsible investing, including trends, practice, performance, and impact of social investing</p> <p>The SIF Ltd promotes the concept, practice, and growth of socially and environmentally responsible investing</p>	<p>Forum membership is US based and is for financial professionals and institutions</p> <p>6 categories of membership: Financial professionals with SRI products; Institutions with SRI AUM; Service providers; Community institutions; Institutional investors; and NGOs with an interest in SRI</p>	<p>Membership fees, with individual fees set at USD 300 per year, whilst others are based on a sliding scale depending on AUM and/or gross revenue of the organisation</p>

Appendix 6: Academic/education initiatives

Country	Name	Objective	Research interests
CAN	<p>International Centre for Pension Management</p> <p>www.rotman.utoronto.ca/icpm/index.htm</p> <p>Rotman School of Management, University of Toronto</p>	<p>Strives to become a global catalyst for improving pension fund management</p> <p>The Centre sponsors research and fosters dialogue that focuses on building better pension 'deals', better pension fund organizations, and better pension legislation and regulation</p>	<p>Agency Issues, including a project that exposes and measures agency costs in pensions management</p> <p>Governance, Strategic Management and Organisational Design, to build effective pension fund organisations</p> <p>Risk Framing, Measurement and Management, including projects on shared risk pension arrangement (and regulation), as well as individual capital accumulation pension arrangements</p> <p>Investment Beliefs and the building blocks for investment policies and processes</p>
US	<p>Pension Research Council</p> <p>www.pensionresearchcouncil.org</p> <p>Wharton School of the University of Pennsylvania</p>	<p>Generates debate on key policy issues affecting pensions and other employee benefits</p> <p>Sponsor interdisciplinary research on the entire range of private pension and social security programs, as well as related benefit plans in the US and around the world</p>	<p>Pension Roles and Functions, examining both public and private pension funds, as they affect and in turn influence labour and capital markets</p> <p>Economics of Retirement and Health, including projects on financial literacy and earnings variability using the Health and Retirement Survey (HRS) project</p> <p>Decumulation Plans, focusing on investment of pension plans, phased withdrawal and annuitization during the decumulation or distribution phase of retirement</p>

Country	Name	Objective	Research interests
UK	<p>Pensions Institute</p> <p>www.pensions-institute.org</p> <p>Cass Business School, London</p>	<p>The purpose of this centre is to serve as a clearinghouse for information on pensions, with particular emphasis on the U.K. system, and to publicize PI research and activities</p>	<p>Pension Microeconomics; Pension Fund Management and Performance; Pension Contingency Analysis and Valuation; Pension Law and Regulation; Pension Accounting, Taxation and Administration; Marketing of private sector pension schemes; Macroeconomics of Pensions; and Public Policy, dealing with domestic and EU social policy towards pension provision</p>
Global	<p>CFA Centre for Financial Market Integrity</p> <p>www.cfainstitute.org/centre</p> <p>Established by CFA Institute as a distinct division with its own executive director and advisory council</p>	<p>The Centre was created to develop solutions to global capital market issues, while advancing investors' interests</p> <p>www.cfainstitute.org/centre/about/pdf/What_We_Stand_For.pdf</p>	<p>Focused on issues of fairness, efficiency, and investor protection in global capital markets and the promotion of high standards of ethics, integrity and professional excellence within the investment community</p> <p>Details of the centre's principles and standards</p>
CAN	<p>The Shareholder Association for Research and Education (SHARE)</p> <p>http://www.share.ca/en/</p> <p>National not-for-profit organisation</p> <p>Created in 2000 by the Canadian labour movement</p>	<p>Improving institutional investment practices that protect the long-term interests of pension plan members, beneficiaries and society in general</p>	<p>Education is a key pillar of SHARE's mandate of assisting pension funds in developing and implementing responsible investment policies</p> <p>Pension investment and governance courses for pension trustees and fiduciaries at basic, intermediate and advanced levels, as well as customized seminars for individual pension plans</p>
NETH	<p>Netspar</p> <p>www.netspar.nl</p> <p>Independent National Institute</p> <p>Formed in 2005 and comprised of over 50 researchers, supported by universities and private and public institutions</p>	<p>Netspar is a national network for research and education in the field of pensions, aging and retirement</p> <p>It aims to stimulate innovation in addressing aging and retirement issues in an international setting</p>	<p>Netspar has three core research programs on macro-economic aspects of aging and retirement (macro), individual behaviour (micro) and institutional aspects and behaviour of pension funds and financial institutions (meso)</p> <p>Netspar allocates 1 million Euro annually to each of the three themed projects, for a three-year period</p>

