

**Paul Abberley, chief executive, Aviva Investors, London 9 November 2011**

**Tomorrow's Company annual parliamentary reception, House of Lords**

## **Investing in stewardship**

It was understandable I think that the initial reaction to the financial market crisis in 2008 was to focus on dealing with the Risk in the system and mitigating the macro economic impact of that crisis.

At the same time it was disappointing that in those early days there was so little reflection about what that crisis said about the suitability of the financial system to support sustainable economic activity in the longer term.

Now it's been wonderful in the last 3 months I think specifically to see almost like a flowering in the desert, a sudden growth in interest in this topic, both in the media and in protest movements and in politics. Suddenly the issue of whether the financial system is correctly structured to support a sustainable economy in the long term is very live and therefore there is a tremendous opportunity now to make progress.

Lord Hascal mentioned now is time we need answers, at the same time Tony referred to the complexity in the city and elsewhere in the economy and therein lies the problem.

I would suggest that if you went back to the 1970's and asked a dentist or a head master to explain how the local bank decides whether to advance a loan and what does a merchant bank do, it wouldn't have been perfect the answer but they would have had a reasonable understanding of how that operated. I would suggest that if you were to ask a Dentist or a Head Master today to explain how Banks decide to advance loans and what investments banks do they would have very little understanding really.

## **Leadership**

Now what that means is, if we were to provide answers the leadership has to come from within the financial services industry itself. There isn't the time to do the education exercise that would be required for broader society to really understand financing. We can try to do a better job there but it's not going to happen quickly enough. So I think it's incumbent on the financial services industry to show the leadership, not to suggest that they can do it single handily, but they have to come up with the ideas and the proposals and the solutions in conjunction with the political sphere and broader society to try to develop a financial system which makes the free market model more effective at delivering its long term goals.

## **Role for value and ethics in finance**

In order to do that of course we have to take an important step forward, which is to acknowledge and accept that there is a role for values and ethics in finance.

I think for the last 20 years there's been quite a strong body of opinion in finance that the city should effectively be A moral and I stress A moral not immoral, and why have people felt that? To some degree, there is defensiveness about going in to the area of ethics because we have to accept if you say there is going to be an ethnical dimension then it's a very messy area because ethnics means so many different things to many people. So I think firms have to be brave and financial market leaders have to be brave in accepting that if you begin to accept the ethnical dimension to what you do its going to be messy, it won't be very clean because lots of people have different views. But it still incumbent on the financial services industry to move in that particular area.

So narrowing it to asset management which is the area of the financial markets which I'm personally involved in and obviously Aviva is a big player in this area, what does this mean for us?

We, as the asset management industry sit between those that own the capital, and they by the way ordinary people, through pension funds and ISA's own this

capital, we sit between them and where that Capital is invested either, in the private or the public sector.

So our role is to ensure that their assets are invested appropriately so they get an attractive return on their investments long-term. That means for us that it has to be invested in an economy which is sustainable in the long term.

That means that we have a very important role in terms of stewardship. It's possible to be an asset manager and absentee landlord. You can buy equities and just sit back and watch them go up and down on the screen and sell them when you think the times right, that ought not to be enough.

If you're an asset manager you should be obliged, or perhaps obligated to be an active owner of equities. That means engaging with companies.

So what do you engage with them about? One relatively straight forward issue is governance. Aviva and some others have been doing this for some years now, ensuring that the governance structures of companies are appropriate, and if we feel there not, meeting with those companies to explain why we think the governance needs to be altered. But that's only one element of it. Equally important and perhaps more important is that ideally we want to understand the long term strategy of those companies.

### **Long-term versus short-term**

Now, the long-term versus short-term is a clear problem in finance and I think most people have to accept that there has been an unhealthy trend towards short-termism in the city over the last 10 - 20 years.

It's something that we are working with Tomorrow's Company on. Looking at the incentive structure and doing some great work in that regard to try and understand why it is that finance has become more short term and what could be done to make it longer term.

It needs to be longer-term if we're going to contribute towards building a sustainable economy. It's the long-term investments that ideally we should be engaging with the companies to discuss.

So what we would ideally want to understand is what the long-term sustainable strategy is for an individual company?

Now when I say sustainable for an individual company I don't mean necessarily in the environmental sense. But what is it about the company's strategy which makes it survivable in the future given that the environmental dimension is going to be changing; given the new demands in terms of the social environment. Has the company thought through the long term sustainability of its strategy? That's the conversation that we want to have with companies, and we believe other fund managers should too.

There is a trend towards asset managers being more interested in this, as indicated by those that have signed up to the UN backed Principles for Responsible Investment. There are now about 900 asset management firms and asset manager owners representing about \$30 trillion dollars in assets signed up to these Principles. They have expressed their keenness to have these types of conversations with companies, but I recognise that there is a lot further to go.

Fund managers have to do a lot more to deliver on what they profess to be a commitment to have those conversations because many companies will argue back that actually not many fund managers will want to talk about that. But we think the momentum is in the right place.

Of course to have that conversation, the companies have to produce the information that's required about that long term perspective for us to be able to address the sustainability of their strategy and discuss that with them.

Now, too few companies today produce that. Again there is a positive trend. More are doing so, but Bloomberg who collate this data very effectively reckon that less than a quarter of companies are producing anything in terms of analysis of this type and with those that produce it, a lot of it falls short of what is required.

So if companies are not going to report on sustainability in the long term, it's very hard for fund managers to engage with them, understand the sustainability of their strategies and then ensure that the capital which we are given responsibility for

managing on behalf of people is directed towards those companies with a sustainable strategy.

We can only steer capital in the direction that it needs to go if we understand the sustainability of a firm.

So Aviva has been working for some years to encourage companies, firstly through a stock exchange initiative to provide more reporting in this area. It's made progress but frankly it's moving too slowly.

### **A convention on corporate sustainability reporting**

We now think the time has come to mandate more reporting of this information.

This is why we're assembling a coalition to take a proposal to the Rio Summit next year which would ask for a convention which would mandate companies at a national level to imbed the sustainability of their strategy within their corporate reporting.

It's not prescriptive. We're not producing excel spreadsheets for everyone to fill in. Each company has to do it in a way that's relevant to them. We don't know what that is, they have to tell us, but in a way that they have the conversations in the board room we want those board room conversations to be expressed in their reporting. If they don't have those conversations in the board room, if long term sustainability of their strategy isn't relevant, then they can explain that. We are not forcing them to make stuff up, it should be on a comply or explain basis.

We believe that if we achieve this in Rio next year it will really turbo-charge this trend towards companies reporting on long term sustainability.

Allied with that, the fund management industry moving more in the direction of analysing this sort of data can help capital flows move in a direction which is more aligned with values and values in the year ahead.

**END**