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Institutional investors fill activism gap in Europe

As hedge funds engage less, pension funds are increasing their activity

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Daniel Summerfield said USS expects companies to consult on material changes and issues.

Activism for long-term change is on the rise in the U.K. and continental Europe among institutional investors, as corporate governance and other concerns climb higher on investor agendas.

Sources also expect activist investors that seek short-term opportunities from M&A activity to rise as the impact of the U.K.'s decision to leave the European Union begins to bite.

“We have seen some of the major groups taking more action in (the long-term activism) space, and it's the major groups that have the power and ability to do things — they could be large asset owners or asset managers,” said Stephen Miles, global head of equities at Willis Towers Watson PLC based in Surrey, England. “These universal owners control a large number of assets in the system, and there is a greater recognition among those groups that it

is worth investing that time and energy to be an active owner and to engage with corporates. They are upping their game."

Mr. Miles said the consultant has encouraged and seen money managers apply increased resources to this area, "hiring and beefing up internal corporate governance teams, in response to the recognition that this is important to asset owners."

Institutional investors are stepping into the breach left open by hedge funds, which have taken on fewer campaigns since the financial crisis. "If one looks at campaigns that were made public by hedge funds, excluding cases of M&A activism, we are still well below the levels reached before the financial crisis," said Nelson Seraci, associate director, special situations research at corporate governance firm Institutional Shareholder Services in Brussels. "However, it seems the void left by hedge fund activism has been picked up by traditional investors, who have become more vocal, especially in the U.K."

Mr. Seraci said the number of activist investors and their assets under management in Europe appears to have shrunk vs. the prior economic cycle, or at least has not grown. He said tactics used before the 2008 financial crisis "were considered aggressive by traditional investors and overly focused on short-term bumps for stock prices," and a number of the strategies also have closed due to redemptions. Those that survive tend to engage behind the scenes, he said.

"Simultaneously, traditional investors have taken responsibility for engagement with companies, not needing in many cases an activist hedge fund to be the catalyst for change. This is mostly true in the U.K., and to a much lesser degree in continental Europe, where other factors are at play," added Mr. Seraci, such as a culture of avoiding public confrontation, legal loopholes or unfavorable regulation, and conflicts for bank-owned money managers.

Active institutional investors

Institutional investors have become increasingly active in terms of airing their concerns in the public domain. Reza Eftekhari, U.K. director at global consulting firm Morrow Sodali in London, which specializes in shareholder services, corporate governance, proxy solicitation and capital markets transactions, noted "institutional investors are more active now than ever before. In the U.K., executive pay continues to dominate the agendas for investors as they are under increasing pressure from their clients as well as the public to hold management of underperforming companies accountable for failures. As a result, investors have less tolerance toward sharp increases in pay packages of executives in cases of poor financial performances."

At least three U.K. companies since the beginning of the year have been forced to withdraw new remuneration policies before an annual general meeting as a result of shareholder opposition, he said. And at least five U.K. issuers have received more than 40% of votes against their remuneration proposals, he added. He did not specify the companies.

In the cases of large retirement plans, such as the £60 billion ($77.7 billion) Universities Superannuation Scheme, Liverpool, and the £1.3 billion National Employment Savings Trust, London, growth in assets translates into relative growth in active ownership and voting.

“We protect our members' pensions by acting as engaged stewards of the investments we make on their behalf — that's what drives our approach to being a long-term, active and responsible shareowner,” said Daniel Summerfield, co-head of responsible investment at USS Investment Management in London, which manages the pension fund's investments. “We invest in high-quality businesses which we believe can create value over time and whilst we are owners of the business, we encourage them to adopt the best standards of governance and reporting.”

Mr. Summerfield said the firm has one of the largest responsible investment teams in the U.K. retirement sector, and “use our influence as a major institutional investor to promote strong (environmental, social and governance) practices in the companies and other assets classes in which we invest.” In practice, that means engaging with boards and executive teams, and using voting rights effectively, he said. In 2016, USS voted on 7,539 resolutions at 623 events, covering 521 separate companies.

USS executives also seek open and two-way dialogue with companies, and expects them to consult on material changes and issues impacting long-term shareholders, Mr. Summerfield said.

“We have always taken great pride in being a long-term, active and responsible shareowner but the scale of our assets and investments has grown considerably in recent years,” said Mr. Summerfield. Growth in assets, which are overseen and largely managed in-house, and “diverse interests in countries and markets across the world” have combined to create a “relative increase in our shareholder activity.”

Mr. Summerfield said it is “very rare for us to publicly air our concerns,” and USS made the unusual move last month when it published a news release calling for “meaningful and constructive dialogue” between paint and coatings maker PPG Industries Inc. and takeover target AkzoNobel N.V. USS' current holding is 1.28% of AkzoNobel's issued share capital, and it expressed concerns at an annual general meeting over fiduciary obligations to shareholders.

“The steps we took regarding AkzoNobel were the exception to the rule, but demonstrate that we will not shy away from using the strength of our voice if we feel that all other avenues to achieving meaningful engagement have been closed to us,” added Mr. Summerfield.

Active owner

Similarly, multiemployer defined contribution plan NEST views itself as a responsible and active owner of securities.

“Although we mostly hold equities via index funds and our fund managers vote NEST's shares, we aim to have as much input and oversight into the voting process as we can,” said Diandra Soobiah, head of responsible investment at NEST in London.

NEST executives have also developed their own voting and engagement policy, setting out viewpoints on important areas of corporate practice. It allows executives to hold money managers to account on the way they vote, she said.

Executives also engage directly with companies. “We take a particular activist role in working with standard setters and regulators, as at this stage in our development this is where we believe we can create most positive change,” added Ms. Soobiah.

As the plan has grown in participants and the investment approach has developed, in-house expertise on responsible investment has also been established, and the plan now has a direct relationship with proxy voting agency Manifest. The firm provides proxy voting and engagement support.

While sources acknowledged that activist hedge funds are in decline, or at least are not showing growth, there is one exception: mergers and acquisitions.

Mr. Eftekhari said the number of activist campaigns across Europe continues to be steady, “and in particular, activism in M&A situations will likely increase over the next 12 months.”

“Instability and uncertainty as a result of global geopolitical concerns such as Brexit, the new U.S. administration and upcoming European elections would impact the financial performance of many businesses in the U.K. and across Europe,” said Mr. Eftekhari. ” n

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