Pensions for Purpose Podcast
Season 2, Episode 5 - Asset Owner Influence

Laasya Shekaran: Hello everyone, and welcome back to the Pensions for Purpose Podcast, I'm your host, Laasya Shekaran, today we have an exciting guest joining us, Dan Mikulskis. Not only is Dan, the man who introduced me to podcasting, and perhaps even worse, Dan I think you're also guilty of introducing me to LinkedIn. So, you've created a bit of a beast there, but of course Dan is also the Chief Investment Officer of the People's Pension, so he therefore represents one of the largest asset owners in the country. Welcome Dan, we are so excited to have you here today.

Dan Mikulskis: Well, what an introduction Laasya! Thank you so much. I'm delighted to be here, really looking forward to the conversation, thank you.

Laasya Shekaran: Brilliant, and my Pensions for Purpose co-host for today's episode is Richard Giles. It's great to have you here as well, Richard.

Richard Giles: Thanks, Laasya Shekaran. Dan, welcome to the Pensions for Purpose Podcast, it's great to see you. We knew each other a long way back in our careers, but it's great to see the work you're doing these days.

Dan Mikulskis: Hi Richard, it's great to see you!

Laasya Shekaran: We're going to be getting into that work, because the People's Pension has been in the news a lot recently due to the announcement they have moved £28bn, you heard that right billion with a b, of equity and fixed income assets to managers they believe are better aligned with their responsible investment values, and this followed a statement they released with a number of other asset owners setting out their commitment to climate stewardship.

So, it's probably one of the strongest examples we've seen recently of an asset owner putting their money where their mouth is, when it comes to sustainability commitments. We'll certainly be getting into that story more during this episode, we'll be finding out what led to the decision, but before we get into that, let's take a bit of a step back and find out more about the People's Pension. Dan, can you tell us a bit about the People's Pension, and how it came about?

Dan Mikulskis: Sure, I'd love to, the People's Pension is a interesting pension fund. It's one of the largest defined contribution master trusts in the UK and the organisation that runs and provides it, which is called People's Partnership, who I work for directly, is also an interesting organisation as well. I'll give you the really short history on those, People's Partnership is an organisation that arose out of the construction industry in the UK.

It has a federated employer with trade-type union roots from back in the 1940s, and it provided a series of financial products to effectively underserved communities on a profit for member basis and watchwords were 'simplicity' and 'straightforward-financial products'. Things like, holiday pay stamps – it was famously the first one in the 1940s, and a variety of other products, including things like: life insurance and latterly pensions, and then auto enrolment. I'm talking about all this like I've been there forever, I've been there a year and a half, let's just stipulate that. I've learned of this fascinating history over the last little while, and obviously others are far more able to talk about it than I am, and they take more credit for it than me of course. In the run up to auto enrolment, they had a pension scheme, which was already a multi-employer pension trust, which was able to be repositioned as a vehicle for enrolment, and because of the profit for member perspective that the organisation had, it was able to offer that to employers of all sizes, so you might remember, and there was a staging element to auto enrolment, where the bigger employers went first and then it went all the way down to your two/three person firms, and because it was not-for-profit, we could offer it all the way down to the very smallest firms, who might not have been considered profitable by the bigger commercial players, and so that meant it became very successful.

We have enrolled about a hundred thousand employers, and through that we have almost seven million members, who contribute a lot of money every single year, about two million of those are active contributors. So, the AUM is up today up to about £32bn, but growing incredibly quickly, we do about $4bn of contributions every year, with that plus investment growth, we have a clear path to being somewhere between £50-60bn we think by 2030, so a wonderful position to be in.

Richard Giles: Great thanks for that, Dan, as it's a Pensions for Purpose Podcast, we'll want to dig into sustainability. So, let's start with the big picture, what's your view on how large asset owners should think about sustainability and the impact they can have?

Dan Mikulskis: So it sounds like you're asking me here about general theory of sustainability, I guess you've given me a lot of credit for having such a theory, but the way I go about these things is I pick my general theories from the work of other eminent people, in the way I think about it, you'll probably see a lot of bits from the work of people like Professor Alex Edmunds, Professor Tom Gosling, who I hold in high regard. I suppose the way I would think about it is saying companies operate out there in the world, and we typically in invest thinking, think in terms of risk and return, when we're putting together portfolios. But there's a whole other category of thing that companies generate, which is externalities and impacts on harms, on society and on people, put another way, areas of intangible value areas that can create value in ways that aren't taken down to the bottom line in the next year or the next couple of years.

There's a whole question mark over how you think about those things in general, and there's a absolutist theory of capitalism that says companies should maximise shareholder value within the law, and I wouldn't subscribe to that – it's slightly too reductive in how it's approaching the world. But it's this broader question of how you can reckon with these other areas of stakeholder value, and whether that's focusing on creating extra value through stakeholder value, or whether it's focusing on reducing harms as a stakeholder value thing, both are in that broad category.

Laasya Shekaran: There's some interesting work I've read that Alex Edmans has done around corporate purpose. So what is the point of companies, are they just there to deliver profits, to maximise, shareholder returns, Or do they have this wider impact on local communities or people or the environment?

Dan Mikulskis: Yeah, absolutely, those impacts are there, whether you choose to recognise them or not, whether they make it into your spreadsheets or not. I suppose that's where I think asset owners come in, asset owners being among the larger shareholders of most companies, it comes with their responsibility to take a view on those impacts. What do we think about them, do we like them, do we not like them and how would we like them to be different? If we would like them to be different, then how would we like that to happen?

Richard Giles: It's an interesting time Dan, for sustainable investing, and we've got two competing forces happening in the world. We can all see the escalating climate crisis all around us, but also in some jurisdictions, politicians pulling back from climate commitments and pushing forward fossil fuel developments. These two forces seem to be in conflict.

Dan Mikulskis: I think what we were trying to achieve there was to provide a clear signal to the market, provide a voice from asset owners. This is a point Tom Gosling has made recently, asset owners are the natural people to try and set some standards on this, and try and be clear on what standards are meaningful. I think it was always a little bit strange when you had these asset manager-led initiatives that were trying to go quite far with that. That was always potentially the wrong set of organisations trying to lead it. But I think asset owners can be leaders, can be clear standard setters, and can come together and hopefully offer a clear signal to managers on what they want in this area. Some of those principles set out in that asset owner statement were important. For example, one of them saying, where possible asset managers should prioritise collaborative engagement – that's an important principle to us that asset managers should prioritise their engagements, and they should also root those in a robust theory of change. So pushing back on this idea that managers can say we did 13,256 engagements in the last year, and another one of the principles being a systematic approach to voting is imperative. These are fundamentals, I wouldn't say they are particularly advanced asks, but it was trying to lay down some basics at a time, when there was clearly a lot of flux and uncertainty in the area, and trying to send a signal to the market, a signal to asset managers, who we obviously all use asset owners in terms of what we're wanting, which we could maybe move forward from.

Laasya Shekaran: This idea of asset owners using their influence more is interesting, because they do seem like the obvious part of the investment chain to be using their influence, setting their standards out, talking about what their values are. They're the ones who ultimately have the money and decide where it goes, but as you say, it seems like the noise hasn't really come from the asset owner camp until quite recently. What do you think is causing the shift?

Dan Mikulskis: Yeah, that is interesting, there's a couple of dynamics at work there. Let me talk about UK perspective quickly, I think in the UK we're in an interesting, exciting moment and there's a chance of us having a much better culture of asset ownership in the future than we've ever had. The UK has always been a fragmented pension system. That's been the case for the 22 years I've been involved in it, and that has suppressed the voice of the asset owner, because there just haven't been enough operating at scale, arguably, just one, maybe two, that we're replacing a scale. I think now, with the likes of organisations like ourselves, Nest and local government schemes. You're going to hopefully get to a place where you've got maybe a dozen big scaled-up asset owners, which is similar to what it's like in Canada, Australia, The Netherlands and Scandinavia.

I think that should hopefully bring the UK in-line with some of those other areas, but even then I wouldn't say asset owners globally have found a particularly strong voice. I suppose that's because for whatever reason the balance of power has rested for a long time with asset managers, and arguably for a long period before that with the investment banking part of the ecosystem. So I think it's a little bit of a mismatch, there's three things that you have got to reckon with: where the centre of gravity of the power you want to measure that resides? Where the centre of gravity of the resources resides? Then, where the actual agency to show leadership resides? There is a little bit of a mismatch with those, I still think you can argue there's an over allocation of resources among asset managers and an under allocation of real agency, obviously because managers are appointed to carry out mandates rather than acting as principals themselves most of the time. It's an interesting moment for the UK. I've felt for a while asset owners are important and special, and need to exist, and deserve to exist possibly, and hence why I've ended up working for one.

I suppose, I would round out that thought bubble, on a positive note, which is in the UK, there is a real chance of the voice of asset owners being far stronger than it has been, because of the change to the fragmentation of the system.

Richard Giles: This is consistent with a piece of research we have carried out on stewardship across the UK pension sector, speaking to 15 of the larger pension schemes down, and one of the findings is, there's more asset owners taking ownership of stewardship, or shifting that balance at least from the asset managers towards the asset owners. So, I think I think it's entirely consistent with what we're picking up elsewhere.

Dan Mikulskis: One quick point to follow on from that thought, the trend of moving to passive is relevant here as well, in that moving to passive historically, has been challenging for better stewardship, I think Alex Edmans has written on this. If you're an active manager, then stewardship obviously comes quite naturally, because: you want to add value, you want to outperform the benchmark, you're always searching for ways those companies can add value and be better. Whereas, if you're a passive manager, it's not as clear that's your job, or that you're incentivised to do that, or that you have the resources to do it, basically. So, it just makes it a trickier backdrop for stewardship, but obviously the trend towards passive over the last ten years has been enormous. So, as much as there's a trend from asset owners using their voices. There's something to be aware of there around the trend to passive, that has worked against what we're talking about here. But to finish on a positive note, I think over the last few years there's been some good examples of how that trend can be unwound a little bit or be pushed back against.

Richard Giles: Should we just dig into the big news Dan, which last week People’s Pensions caught the headlines with moving £28bn, which is obviously a huge amount of money, towards two managers that were, I think, the phrase that was often quoted, more aligned with the beliefs and objectives of People's Pension, and I'm sure our audience would be interested to understand the thinking that's gone into that decision.

Dan Mikulskis: Yeah, sure. Absolutely happy to Richard. Yeah, it was big news. It's always wonderful to get those announcements out, that was the culmination of almost a year of work from people across my team and other organisations. So, a ton of work going on in the background, in one way, the backstory behind was we keep our manager appointments under review, as any large asset owners do. We had all of our assets with one manager, which is a little unusual when you get to our size, so we were expecting to expand the number of managers we were working with anyway, and we were conducting reviews of those portfolios and that concept of alignment that is key on the responsible investing side. As you'd expect, we assess managers on a balanced scorecard of all sorts of factors, which include portfolio construction, risk, management, team business and all that, but responsible investments being a key part of it. Focusing in on that part of it, alignment was the tool we used, we published a responsible investment policy last April, which laid out in quite a lot of detail, how we would like stewardship to be carried out on our assets, it even went to the level of detail of vote against management in these situations, vote against directors in these situations at these companies, when this is not being followed.

So it was a really detailed responsible investment policy, and the responsible investment element of the scorecard for these managers the question really was, who was best aligned to fulfill that policy? One other significant nuance that plays into that is the question that are you talking about firm-wide alignment, or product-level alignments? That was something we discussed a lot along the way, firm-wide alignment being the sense that the firm at a top level is acting in a way aligned with the policy. That is often in terms of the collaborative things, it's part of the initiatives it's participating in, it's top level C-Suite firm-level beliefs, or product-level, which is a level down from that, where maybe at the firm-wide level, are taking a neutral stance, but at a product-level you can see alignment with it. I think those two different concepts were helpful,either of them could work in different situations and different asset classes.

We were clear that for the equities, we wanted to get firm-level alignments, because that's where typically with equities, you've got a voting engagement strategy, and that tends to be a something that's determined, as one per firm, and it's determined at firm level, normally. So we grappled with those two concepts. It's important to say, I don't think they're quite the same, Isometimes managers can downgrade themselves to a product-level alignment, and try and claim that's no different to where they were before. It is different, it doesn't mean that it's not nothing, product-level alignment is still important. But yes, we were just trying to get over that last year, grapple with what those two things were, what that meant to us, and then try and assess managers relative to that that alignment. There obviously has been a lot of movement in terms of where managers are positioning on that over the last year, and so in some ways I would say it's become easier to assess alignment, than maybe it was a few years ago, when the landscape was a little more homogeneous. Now you're able to make assessments and make judgments of alignment, so you can use things like voting track records as well.

Laasya Shekaran: Dan, that fits in well with some comments I've heard you say about how you want to partner with asset managers and how that asset owner/asset manager relationship works. It makes sense that if you want a strong relationship, you need to look at what they're doing as an institution, so as a firm-level, not just what their products doing.

Dan Mikulskis: Yeah, exactly, that's key to that mindset as well. That's part of our philosophy to have a small number of deep partnerships with managers, where we can get value out of those partnerships, whether that's around insights and data, and I don't know whether it's around policy, engagement or what have you. There's all sorts of areas that managers have significant resources, that we would like to tap into. We feel we can best do that with a small number of relationships significant to us and significant to the manager on the other side as well.

I think that's running a little bit against the grain in some ways. When I was a consultant, the trend was best of breed in every single area and slicing the portfolio into smaller bits. So, you're running up against that. We believe in the partnership approach, as you've identified, that then does get quite inconsistent with trying to identify firms that are aligned with you at firm-level.

Laasya Shekaran: What do you think is going to be the impact of the changes you've made? Because obviously, they've been picked up everywhere, the whole world has seen what's happened. Do you think other asset owners are going to be following suit, what's going to happen next?

Dan Mikulskis: Yeah, you'd have to ask them, I suppose. I'm not sure, I feel that level of change is probably unusual in UK pensions. I'm grateful to my team. We've got a team that have really gone at it with a lot of energy. We've put together a varied and diverse team, that's experienced across loads of other areas. So, we weren't held back by the legacy perceptions of what can or can't be possible in UK pensions. We just said we're going to do this, and people went at it with a lot of energy, which was nice to see.

Yes, but perhaps it will reframe expectations for what you can do for others as well. I think if you put your mind to it, it's certainly doable to make these changes in terms of the impact for us. Obviously, we would hope it would mean our shares were being voted in the way that's most consistent with our policy, which is what really matters to us, and members of our pension scheme can be confident things are being enacted in line with policy we set out, so when we said these were the things that mattered to us, these were the standards we wanted companies to operate to, that was actually being followed through and wasn't just something we were saying, and then unable to put into practice.

Richard Giles: Thanks, I'd like to change tack if that's okay. We thought this was going to be the big story to talk to you about Dan, which was the announcement a little while ago, but not too long ago, that you were increasing allocation to private markets. I think it's roughly 10% of the fund, or £4bn, another big amount of money, but that itself is an interesting development, we'd like to know the thinking and the motivation behind that, but also what underneath-the-bonnet allocation might look like?

Dan Mikulskis: Yeah, absolutely. We've been lucky. We've had a few interesting developments to announce recently, so it's good to keep the media on their toes.

Laasya Shekaran: Yeah, you've made our lives difficult narrowing down what to talk about. There was another one around becoming the advisor as well?

Dan Mikulskis: That's right.

Laasya Shekaran: Honestly, we're going to need to have a part two to this Podcast, aren't we?

Dan Mikulskis: The private markets was a big announcement. Yeah, obviously private markets is an interesting area. We're coming at the whole thing by asking ourselves how we can add more value to members' pensions overall. I can honestly say that is what gets me up in the morning every day and puts a spring in my step when I go to the office, and it's the same for my whole team. So how can we really add value to members, pensions and private markets has a role there.

We wanted to make sure allocation was significant enough, that it would make a difference. We could go and put a quarter of percent of the fund into almost anything, and it might not really make any difference to members outcomes whatever it did. So it had to be quite significant, but we also had to be clear that it was doing it in a way that would leave value in the hands of members.

I do think, and I've said this before, too many times in this area, there's assets that are identified that hold an advantage in terms of returns, and almost all of that is turned around and paid back to the managers and fees. It shouldn't happen, but it does happen all the time, and we wanted to avoid that. So we felt we were getting to a size where that was now possible, because of the ability to do things like co-investments, direct deals, as well as pulled funds. That was a bit of an unlock in terms of the size, and we were far enough along in terms of conversations with managers to have a concept, have a structure that we thought could work, be made to work at a great fee level as well. That would fit nicely into what we were doing, and that would allow us to get up to that 10% allocation, which I think is where you can say it's going to potentially add value to members' pensions. So what we're looking at there is real assets, infrastructure and real estate. I think those have been institutionalised in terms of the way they can be allocated. You can typically look at open-ended evergreen type structures which is nice.

Often you'll be looking at performance fees in terms of core, even core plus assets. Definite opportunity to do co-investments to really scale-up, get bigger allocations in there at good fee rates. So there is a lot of things to like about that, and then there's the question of where should that be? Should it be UK? Should it be global? We're standing this up on the basis of returns, as we do with all our investments, and saying that the things we allocate to have to stand up on the basis of returns rather than other factors. I think we can say, why not give us a first look to UK assets in this particular area, and there are a couple of reasons why UK assets have a small but real advantage over other assets: one is it's basically less costly to access them. So whether you're accessing them directly or paying a manager, it doesn't matter, but because you can run a smaller, more local team, they're just less costly to access. So the asset management fee will be less by a margin, not tons, but not nothing. Then currency hedging as well, currency hedging is also not free, you've got to hold cash and you've got to pay someone to do derivatives. You've got to spend time and effort settling it. So you add those two things together, and I think an equivalent UK asset has a little advantage over the equivalent asset elsewhere. So why not look at the UK first. You can do a little bit of analysis of the historical infrastructure volumes in the UK. It's a bit less than you would think, it's not huge, but there's a pretty solid pipeline. For example, in renewable energy, look at battery storage that have all re-rated to healthy return levels. There's a dynamic there, where they really are competing for capital quite effectively. So that's the core of the thinking there.

Laasya Shekaran: Infrastructure is an asset class, where there's clear opportunities to invest sustainably and make an impact. You talked about how the energy transition is one of them, but you've also got healthcare and other institutions as well, is that forming part of your decision making when it comes to your private market allocation?

Dan Mikulskis: A little bit, I think the overriding thing has to be standing these opportunities up on the basis of returns, first and foremost. We're looking for hurdle rates to global listed equities to get in the portfolio, and then hurdle rates for like-for-like assets elsewhere. I wouldn't say we're going down the road of looking at accepting concessionary returns for things that have good impact characteristics.

I think other asset owners are going down that road a little bit, the more I hear, and some of them being quite upfront about it, which I think is good. I think there certainly are areas of the private markets where you do see effectively lower expected returns from projects that have those kind of characteristics. So that would be one thing I would always be a bit cautious of in that because you have some asset owners who do pay concessionary returns. Areas that have particularly good characteristics might well have their returns pushed down, it doesn't mean they always will, though I think it can be a little bit of a false jump to say anything that has good characteristics will have lower returns. I don't think you can always say that.

All I'm saying is, you just have to evaluate each project on its merits, looking for risk/return, and because of the plans for the build out of clean energy in the UK, the market mechanism means those assets have to incentivise capital to participate, which ought to mean they're actually well priced. That does seem to be what's happening. It's nothing more, nothing less, than a simple market driven mechanism. That's saying that this is a build out that's happening, and these projects are becoming available at rates of return that are competitive to get capital to participate, which is as it should be.

Richard Giles: It's a really interesting comment you make about the UK and renewable energy investments. We see a lot of that opportunity in our networks as well, but I think some of the pension schemes find it hard to find those opportunities, and maybe operating at scale gives you an advantage with that. Just the final question I've got Laasya, if it's okay, is around fiduciary duty, and whether that comes into the consideration, or whether the primacy of returns in your thinking is clear, but whether fiduciary duty ever holds back or limits, or it's a discretion around the trustee table? Is there anything in that issue that is a constraint for what you want to do?

Dan Mikulskis: Fiduciary duty is certainly often discussed, it comes up all the time, and it certainly came up when we were writing down our responsible investment policy. When we did that, we tried to really focus a lot on getting as clear as possible on the objectives and trying to tease apart financial and non-financial factors We wanted to do that, because a lot of asset owners blur those lines, and it ends up being a document full of win-wins and not actually facing into the trade-offs. I think we're trying to deliberately face into the trade-offs rather than trying to pretend they don't exist, and I think fiduciary duty is broadly helpful.

My view on fiduciary duty has always been that it probably doesn't stop you. I don't think it really stops progressively minded groups of trustees from doing what they want to do, but it provides quite a useful push back against other vested interests, trying to push things in different directions. I don't think if fiduciary duty is, it's not particularly clear cut. You're not going to be able to look at two different assets, and it's not going to give you an answer a lot of the time. It does leave plenty of wiggle room, yes you can say, does that mean it might leave some fiduciaries feeling slightly exposed in their decision making, maybe, and I can see why people want to pursue reviewing it or refining it, or making it clearer and that's fine. My perspective, from experience, is I wouldn't say it's particularly an impediment; I think it can be a reasonably useful defence against things going too far down a certain road.

Laasya Shekaran: Dan, we've covered loads in today's episode, lots of food for thought for everyone. The partnerships between asset owners and managers, the role of asset owner influence. Of course, all the headlines that you've had, and some interesting discussions on the dynamics of UK markets. If there was one thing you wanted listeners to take away from this discussion. What would it be?

Dan Mikulskis: I would say it's I think asset owners' influence can have sometimes been a little bit overstated, but it is still a thing, that the asset owners do have influence and by thinking carefully about it, and in some ways recognising the limitations that it has, you can unlock the full potential impact of it. I think there's a positive message there, that being realistic about the potential influence and being realistic about where the world stands today, is actually how you can unlock the most influence from what you do.

Laasya Shekaran: Brilliant, we love a realistic, but positive message to end things on. Thank you so much for joining us listeners. If you want to make sure you never miss an episode, hit the follow button and remember you can find us wherever you get your podcasts. Thanks for listening and see you on the next one.