HOW TO IMPROVE THE PENSION FUND ENGAGEMENT: A RESEARCH PROPOSAL FOR ITALIAN PENSION FUNDS

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Abstract

With 167.1 billion euro managed in 398 pension schemes for the benefit of 7.9 million policyholders (COVIP, 2019), Italian pension funds (PFs) collectively have the potential to be one of the most influential Italian institutional investors.¹ Given the economic weight of the assets managed and their social importance (due to their fiduciary duty towards their policyholders), PFs can influence and participate actively in the investee company’s decisions and literature has shown the importance of activism of this type of institutional investors (Gillan & Starks, 2000; Clark & Hebb, 2004). Institutional investors’ activism may be promoted through favourable legislation, but also through the adoption of good governance practices. In this regard, with the Legislative Decree No. 49 of 10 May 2019² the Italian legislator required institutional investors, including pension funds, to shift their focus to the medium and long-term investment strategies and to develop and publish their own policy which

¹ More generally, PFs are a financial vehicle used by millions of people in advanced countries to accumulate savings for retirement and are becoming one of the most important categories of institutional investors, whose assets vary widely across countries. For example, in 2017, OECD countries reached a peak of 43.4 trillion dollars. See OECD (2018).
should describe how institutional investors engaged with investee companies. The transparency duty is also a key factor in the Legislative Decree No. 147 of 13 December 2018\(^3\) where the legislator required to disclose information about investment’s strategies and to monitor environmental, social and governance (ESG) risks. Therefore, we maintain that these legislations have created new challenges to PFs such as pay more attention to shareholder engagement, seeking changes in the investable universe to meet ESG standards, new investment methodologies and the integration of ESG criteria into investment strategies. So far, Italian PFs have not published policies on engagement activity and they are still a step behind other institutional investors in terms of activism. Based on this framework, our aim is to understand what key issues that prevent PFs from being active owners and what possible solutions PFs could adopt in order to play an active role in the corporate governance of investee companies. Starting from pension funds’ difficulties, this paper develops a research proposal for describing and analysing the behaviour taken by pension funds and aims to present possible best practice. The research question that guides our paper is as follows: How to improve the Italian pension funds engagement?

In the literature, we identify two “megatrends” that emerge in developed countries as a new way of forms of dialogue between investors and investee companies: ESG engagement and collective engagement. These engagement’s declinations turn out to be a novelty regarding the traditional one-to-one dialogue between investor and company on typically governance’s issues, although remains unclear how corporations and stakeholders can engage in effective dialogue (Esposito De Falco et al., 2018; Cucari, 2018; Cucari et al., 2019). In recent years, institutional investors have accompanied their interest in short-term returns with a long-term one as the business’s prosperity of the investee company. ESG engagement fits into this line (Wagemans et al., 2018; Gond et al., 2018). Integrating ESG factors results in better-informed investment decisions and give the chance to take the potential environmental impact into account. For example, Barko et al. (2018) find that firms with a good ESG track record prior to engagement are more likely to comply with the requests of the activists. Firms that did not care much about ESG issues continue to do so as they seem reluctant to adopt their suggestions. Therefore, ESG engagement is a great opportunity to create both financial and non-financial value towards the investee companies, and more and more PFs stated that they consider ESG factors in the selection process (Hunter, 2018). In this framework, it is important to remind that shareholder engagement may be classified in different ways (Goranova & Ryan, 2014; Rehbien et al., 2013; McNulty & Nordberg, 2016): routine and extraordinary engagement; according to pathways of owner behaviour or again according to the level of engagement privacy. In any case, two of the reasons why pension funds do not engage with investee companies are the high costs and the limited weight of their individual

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investment in the investee company. However, these disincentives disappear when engagement is performed collectively. Collective engagement can save time and reduce costs in that the collective organization coordinates the actions of its members and acts as a large investor. Collaboration is the best strategy for pension funds as through the establishment of associations it is possible to share skills and resources. As shown by Doidge et al. (2019), examining the activities of an investor collective action organized called the CCGG⁴, the formation of an ICAO⁵ changes the economics of activism. Through collective action, members better served their common interests to improve firms’ governance compared to outcome arising from the individual, unorganized actions.

In order to understand PFs’ behaviour, we adopt a qualitative approach, submitting a survey to a representative sample of Italian PFs. A survey research is the only appropriate method to estimate what percentage of some population has specific characteristics, attributes, perceptions or opinions that are of interest to the researcher (Salant & Dillman, 1994). The main objective of the survey is to describe the level of knowledge, practices, and commitment of Italian PFs in relation to engagement and proxy voting. The survey would like also to describe the perceptions of PFs about the extent to which the new legislations compels or encourages them to adopt engagement and voting strategies in their business. This paper aims to make two contributions. First, despite a large amount of research into several problematic aspects of the governance structure of Italian PFs (Bripi & Giorgiantonio, 2010), there is little knowledge of engagement causes, processes, and consequences. The preliminary data will be analysed and read in a wider context in order to propose a real solution to the pension fund’s engagement myopia. First evidence has shown a lack of activism by Italian PFs and this research aims to make the PFs account for difficulties they have and get a change in PFs’ behaviour through the implementation of possible adequate solutions. Second, PFs need to apply engagement in collective forms to become active actors of the process and become a pillar of Italian corporate activism. In this regard, this work aims to be an incentive for Italian PFs in taking this substantially unexplored route.⁶

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⁴ Canadian Coalition for Good Governance (CCGG).
⁵ Investor Collective Action Organization (ICAO).
⁶ First steps on collective engagement have been done by Cometa pension fund which joined 14 mutual funds for a dialogue with banks to verify their approach to climate change. For the first time a pool of institutional investors, for a total assets of more than EUR 20 billion, called for a response from banks on environmental sustainability issues, with the aim of initiating a dialogue with the major international credit institutions to verify their approach to climate change in financing policies and to stimulate the adoption of virtuous behaviour (source: http://www.cometafondo.it/news/ultime-notizie/impegno-cometa-promozione-cultura-investimento-sostenibile).
REFERENCES


