ESG - time for trustees to take control

Vassos Vassou explains why trustees need to be leading the way with ESG matters

Public concerns over environmental, social and governance (ESG) issues grow stronger and louder almost daily, from marches on climate change to bans on plastic, the move away from fossil fuels and towards electric vehicles, and divestment from sin stocks. This is a very overt factor that has helped drive a great deal of pensions debate covering ESG matters. As asset owners, it is now time for trustees to take a lead on ESG.

From 1 October 2019 a pension scheme's Statement of Investment Principles (SIP) must cover how trustees take ESG considerations into account. Furthermore, from 1 October 2020 trustees must report on how they will comply with sustainable investing (evaluating long-term risks, including sustainability risks arising from corporate governance, environmental or social impact), ethical issues (how does the scheme take account of members' ethical concerns with regard to their investments) and stewardship (the exercise of formal rights such as voting), and other forms of engagement with the businesses in which a scheme invests.

As trustees we own the scheme assets. We have an obligation to provide effective stewardship and act responsibly on behalf of our members. This covers voting at company meetings and engagement with company management when required. We can influence corporate behaviours by investing in businesses with high ESG standards and disinvesting in those with low ESG ratings. In practice, this is likely to mean that we will need a close relationship with investment consultants who will help us with this work and with investment managers who are moving the money around on our behalf.

This is all well and good but I have some observations that worry me. The first is that too many trustees are not yet fully focused on ESG. Some sceptical voices on trustee boards say that 'we can't do anything about climate change', 'we don't really know what members want', 'we have passive investments so ESG doesn't apply' or 'we are one of many investors in a pooled fund so can't influence the manager'. Younger generations seem to worry more about ESG but trustees tend to be older. Are trustees out of touch with ESG just because of their demographics?

A second observation is that the support trustees receive from their investment consultants on ESG is generally poor. I am fortunate to work on multiple schemes so I get to see what different trustee boards are doing and what their advisers are saying. I have seen many investment consultants telling trustees to simply add some vague words to the SIP so that they are compliant with the new requirements. The statements they are asking trustees to add to their SIPs are wishy-washy at best and meaningless at worst. This makes investment consultants appear weak on ESG. It is ironic that trustees pay investment consultants handsomely but it sometimes feels that it is a case of the blind leading the blind.

The only party making positive steps on ESG is the investment manager, something they are very good at publicising. Of course, their aim here is to attract the attention of the consultants and trustees so that more money is invested with them. This means more fees.

For me, the balance is wrong. Trustees are the assets owners, so they should be telling their investment managers what to deliver on ESG. Trustees can then measure investment managers' performance in the normal way. Investment consultants should be helping trustees to assess the ESG performance of the investment managers and if the investment consultant highlights poor ESG performance then the trustees should move their money away. This means that investment decisions on ESG are treated in exactly the same way as investment return performance decisions.

Trustees need to appreciate that ESG is here to stay. The ESG investment process is likely to change materially in the next few years. It's time for trustees to take back control and hold their investment consultants and investment managers to account on ESG.

Written by Dalriada Trustees professional trustee Vassos Vassou