ESG: Cutting through the noise

Summary
• In recent years, the amount of talk and corresponding information on ESG and sustainability has been ever increasing.
• Trustees on the whole are coping, although the small- to mid-size schemes may be feeling somewhat overwhelmed.
• Trustees are encouraged to take a step back and think about what is right for their particular scheme, especially in the race to net zero.

The topics of ESG and sustainability are dominating pension agendas for all the right reasons, but are pension schemes coping with the overwhelming amount of pressure this is putting on them? Francesca Fabrizi asks

5 June 2022 was World Environment Day, a United Nations day aimed at encouraging worldwide awareness and action for the protection of the environment. Using the hashtag #OnlyOneEarth, the campaign called for "collective, transformative action on a global scale to celebrate, protect and restore" the planet.

However, pension trustees, as gatekeepers for billions of assets under management, do not need a special day to remind them of their role in protecting the planet. There has been a deluge of information, guidance, regulation and some might say pressure thrown at them about what they should be doing, particularly around environmental issues in recent years, and not only in relation to the 'E' in ESG, but the social and governance aspects too. But has it all been too much?

"There has been a lot for pension funds to consider with regards to ESG and sustainability," says PLSA deputy director of policy, Joe Dabrowski, "and there has been a lot of change over quite a short period of time – updated regulations, updated guidance, updated codes in combination with better data and more analysis.

"We've seen changes to the stewardship code; changes in guidance from both The Pensions Regulator and the Financial Conduct Authority; plus regulatory changes with the Pension Schemes Act. We've had in-depth (and helpful) information from groups like the Institutional Investors Group on Climate Change (IIGCC). There have been implementation statements. There have been updates on the PRI code, and so much more, so a lot in a really concentrated period of time."

The past two years, he continues, have been particularly extreme. "It's always busy in pensions. There are always lots of things happening, but it feels like a lot of big things happened in an overlapping period – partly because of legislation, partly because of the pandemic, partly because of COP26.

"If we look back even at the last year, for example, there were probably close to 70 to 100 consultations on issues affecting pension funds, in one way or another, from admin through to investments and member communications. That's a lot for pension funds to have to deal with."

On a positive note, he adds, by and large, pension schemes are coping well with all of that.

One reason for this, argues PTL managing director, Richard Butcher, is that schemes finally understand what ESG and sustainability are all about, what it means for their schemes, and they are keen to get on board.

"ESG is about mitigating long-term financial risks. Sustainability is about mitigating long-term financial risks. Quite often, that's all consistent with making sure that we've got a world that is a better place.

"When we explain that to our co-trustees or committee members, generally they get it. They're more than happy to use the influence that we've got on a particular board to try to make the world a better place.

"So, we're all on board with the concept of investing in a better way, managing those long-term financial risks, thinking about the climate, trying to do good, trying to do well, and insofar as it doesn't conflict with our fiduciary responsibility, that's what we'll do."

The challenge hits, he continues, when it comes to dealing with all of the statutory and regulatory requirements. "We have to have statements of intent, statements of investment principles. We have to set out our policies and philosophies. We have to set out implementation statements. We have to set out TCFD reports, with huge amounts of information, huge amounts of reporting, and with the best will in the world, these things, although they're aimed at the member, are rubbish communication materials."

Striving to do more

So while most pension funds understand what ESG and sustainability is all about, and are on board with the reasons behind it, there will always be some that are doing it better than others.

Aon co-head of responsible investment, Tim Manuel, explains: "I work with a lot of different pension schemes and a lot of different trustees and I've seen the full spectrum.

"There are three characteristics I see in schemes that are coping well – the first one is that they understand their role as trustees and the significant part they can play in all of this."

Not all trustees, he continues, fully appreciate the influence and the power that they have. "Trustees are at the top of this enormous decision-making pyramid, and those who have a good appreciation of that deal with this best. Any decision that trustees make can have a huge knock-on effect as it essentially trickles down that pyramid.

"So, actually their role is about directing what happens in that pyramid beneath – which means setting the right tone, asking the right questions, but also acknowledging that most of this work is going to get done by others. The best trustee boards are ones that are acting strategically, acting like a proper board, trying to understand the issues, asking the right questions to identify who can help and they are setting clear goals and expectations."

Having the right attitude and approach, and wanting to add value, is the second characteristic of schemes that are doing well, argues Manuel.

"Regulation has of course been a catalyst to having lots of discussions around ESG and climate that would never have happened before. But I've seen a mix of approaches to that – some trustees just want to comply. With that approach, though, you get costs, but you get no value because all you're doing is ticking a box, and not really engaging with it.

"The better approach is where trustees seek to get some value from it. They know they've got to do this but, given that they're incurring these costs, they feel they might as well see what value they can get from it. They therefore engage with the process, and normally those initial conversations and discussions turn into something more."

Finally, it is the schemes that are more willing to work differently, says Manuel, that are finding it easier to adapt.

"Part of this is about raising the bar in terms of expectations. There's lots of support out there for trustees, lots of different ways they can work with that support. The trustees and pension schemes that are more open and more willing to working differently are the ones that are finding it easier to adapt, whereas those that are a bit more fixed on the old ways of working are finding it more challenging when it comes to adapting."

What trustees have to do is pretty clear, claims Manuel, but when they look at what else they could do, that is when the possibilities open up. "I can understand how some trustees find that quite overwhelming, but there is a lot of support out there for them. Most pension funds operate with an investment consultant and a variety of other advisers that should be on top of all of this. They normally work with a whole load of fund managers and while it can be sometimes a challenge to cut through some of the high-level messaging that comes from fund managers, those fund managers have a huge amount of resource behind them.

"So, if the trustees are asking the right questions of the right people and directing them in the right way, then they can get all these different parties working on their behalf to support them."

Taking a step back

There is no doubt a wealth of resources available on the whole spectrum of ESG. The PLSA, for example, even has an ESG hub on its website intended to be a one-stop-shop for PLSA members looking for resources and information on all things related to responsible investment. Dabrowski comments: "We have put out simple guides for trustees, introductions to ESG, more specific and technical guidance on things like implementation statements and the CET tracker. We published our stewardship and voting guidelines earlier in the year and, when we talk to our members, a lot of them embed that in their work."

But as important and useful all the information out there is, says Sackers partner, Stuart O'Brien, even that can be overwhelming for trustees. "Every day there's another guide, publication or report on the topic of sustainability so trustees are possibly feeling a little overwhelmed, particularly the smalland mid-size schemes. The very large schemes have in-house teams and the ability of trustee boards to delegate lots of activities. Small- and mid-size schemes, perhaps less so – there might be a single pensions manager who's expected to do everything."

It can feel, he warns, for a lot of small- to mid-size schemes, that there's a lot out there and they do not really know where to start. "Therefore trustees occasionally need to take a step back and look at what's important to their scheme in particular."

There's a lot of clamouring, for example, for schemes to make net-zero commitments, with big names such as the M&S Pension Scheme making ambitious pledges to reach net zero across their portfolios in the years ahead.

"That may be something that trustee boards want to do, of course. But I don't think any trustee board should feel bound into taking a particular set of actions – they should look at what's right for their scheme and what's right for the time horizon of their scheme as well," says O'Brien.

For example, there are plenty of mid-sized DB schemes that are planning to be fully bought out with an insurance company in the next five years or so. "So, for them, their priorities are going to be slightly different – they're probably already very well-funded, and heavily de-risked. Yes, they may have to take certain actions to comply with the latest bits of legislation, but the important thing is that they do what's appropriate and proportionate for their scheme.

"Then there are other schemes with longer time horizons, including DC schemes, that will, in many cases, want to think about their long-term investment priorities and might feel that net zero is something that could be key."

To assist schemes in this area, Sackers have produced a *Getting to net zero* guide for trustees, the objective of which is to support pension scheme trustees in understanding the legal and practical issues that need to be considered as they address the question of whether or not, or how and when, to get to net zero.

"Not another guide, you might say, but there are lots of people talking about what a net-zero commitment might look like and how you should go about doing it, but we didn't think there was very much on what to think about before deciding whether to make a commitment at all," says O'Brien.

"Some of the questions we see trustees wrestling with include: Can we make this sort of commitment to decarbonise our portfolio? Is that consistent with our fiduciary duties? How does that fit with the latest climate regulations? If we want to do it, what does that look like in practice? What have other schemes experienced when deciding when to make the commitment?

"This guide looks at some of these questions, includes some legal commentary, and importantly includes some client experience, with HSBC and TfL commenting on what they've done in practice to put in place net-zero commitments."

Commonality and working together

Looking ahead, it does not appear that the noise around ESG and sustainable investing is likely to lessen any time soon, according to Manuel. "I don't think it's going to get any less intense in the coming years. The UK pension fund management industry has been a bit of an early mover in this space, and it is going to be continually adapting to get better and better and evolve."

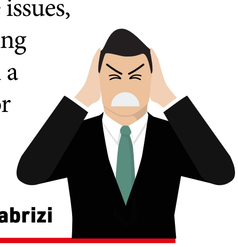
RisCura head of research, Faisal Rafi, concurs. "It is likely that schemes are overwhelmed; and it is uncertain but we anticipate demands on schemes will continue to increase in the short term as beneficiaries, regulators and other stakeholders require more information. The schemes are reliant on their asset managers for this information and there is a large degree of variability within the industry. There is currently no standardisation of disclosures."

This standardisation and commonality, argues Butcher, is key to making lives easier for trustees going forward: "We need some common objectives. There's no commonality yet and, as a consequence, everybody's running around slightly confused about what it is that they've got to do.

"We are all on board with the underlying principle of investing in a risk-aware way, specifically in relation to ESG and climate. We want to do good, we want to do better, but on the reporting stuff, there is too much of it, and importantly there is no consistency. So it just absorbs a huge amount of time, and money, and actually distracts us from the main substance of what we're trying to achieve."

Dabrowski agrees that there are "gremlins in the system" that could be overcome with some level of consistency: "Because of the pace of change between some of the regulatory changes, things aren't always as consistent as they could be; or not all happening quite in the sync that you might like them to. For example, for an end owner, it would be a lot easier if some of the obligations might have been on companies and others to disclose. If you're disclosing and the person you need to get the information from hasn't yet got a legal obligation to do so and is only doing it on a voluntary basis, or hasn't got a standardised way to produce or give the information to you, then that makes your life harder."

But all in all, he concludes, people are committed avidly to finding ways of doing everything smarter going forward, because any wasted effort is largely going to be paid for, in one way or another, by the scheme member. "There's much more awareness of some of the issues, and people are really trying to tackle them. We are in a really interesting place for sustainability."



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