Ahead of the game

Duncan Ferris explores what is driving the rise of ESG and why it could be important for schemes to stay one step ahead of both members and regulators

Considering environmental, social and governance (ESG) factors has never been so fashionable. Climate consciousness is hot right now, with President Biden having realigned the United States with the Paris Agreement, and major companies such as LGIM setting out their own climate pledges. This is not a fad, and pension schemes might be wise to stay ahead of the curve.

Engagement

It is perhaps first worth noting that ESG integration can have some unexpected positive side effects. Staying connected with members should always be a key concern for pension schemes, but it is even more relevant than usual as the industry mulls issues exasperated by disenfranchised savers, such as small pots. But one connection trustees might not have made is the way in which ESG integration can be used to pique member interest.

Sackers partner, Stuart O'Brien, says: "Ultimately if members feel that their money is doing something useful and that they can relate to, then they may be more inclined to pay attention to that letter headed 'your pension' rather than just throw it unread into a drawer."

KPMG head of consumer markets, leisure and retail, Linda Ellett, agrees, pointing out that the firm's research found a quarter of customers "consider ESG factors when making purchase decisions, therefore communicating with consumers on how their pension investments can also support ESG will engage them in an emotional and more effective way".

However, O'Brien cautions that trustees must "bear in mind the limitations on member engagement". He warns: "The law is quite restrictive in terms of the extent to which trustees can base investment decisions on non-financial factors and member ethical or moral viewpoints. So, trustees should proceed with care on things like member surveys. But certainly, trustees shouldn't take the law's restrictions as a licence for a lack of transparency and accountability."

Beyond consumers

Consumer interest in ESG is on the rise, but it is worth considering what drives the topic's prevalence, as that will prepare trustees for how to shape their response.

Ellett explains: "As consumer brands and retailers share their ESG activities with their customers, through advertising, product labelling and bold public statements, the ESG agenda has risen up in the consumer mind, and an increasing number of individuals want to play their part in making a difference."

The Investing and Saving Alliance technical policy director, Jeffrey Mushens, says that "governments and regulators are keen to ensure that investors in financial products as well as trustees and members of pensions schemes understand and can meaningfully disclose to beneficiaries on the ESG-ness of their investments".

Pensions and Lifetime Savings Association director of policy, Joe Dabrowski, points to factors including "campaigners such as Greta Thunberg and David Attenborough", but notes that regulatory effects, including "in the Pension Schemes Bill, alongside the government's recent consultation and publication of a TCFD roadmap", are also having a major impact.

Regulation

As readers will be aware, current ESG standards for UK pension funds require trustees to disclose details regarding their ESG considerations following changes by the Department for Work and Pensions. Given the way the tide is turning, it seems likely measures will become more stringent, though this gives pension funds a real chance to make a difference.

Ellett comments: "Whilst consumers are expressing preferences relating to ESG credentials of products and services, the role of investors in driving business changes cannot be understated. Pension schemes are major investors and whilst 80 per cent of companies worldwide now report on sustainability, reporting only drives change if investors are require it."

As such, it seems key that trustees ensure that they are ahead of the curve on ESG, so that when new tighter regulations come in their funds are already prepared to meet them.

Dabrowski concludes: "As society continues to challenge the way we live our lives, pension schemes need to be prepared to meet members expectations as they grow and evolve."

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In association with Legal & General Investment Management