Going green

In January, the Barclays Bank UK Retirement Fund (UKRF) announced the integration of environmental, social and governance (ESG) factors and climate risk into its £1.3 billion Diversified Growth Fund (DGF). Jack Gray speaks to UKRF CIO, Tony Broccardo, on why the fund made the changes and how it will be affected

The DGF, managed by BlackRock's Factor Based Strategies Group, is the main building block within the default option of the UKRF defined contribution (DC) scheme. Its integration of ESG factors and climate risk aims to reflect the trustee's responsible investment policy, and introduces explicit focus and application of ESG factors into investment decisions to try and better manage risks, including climate change, and generate sustainable, long-term returns for members.

What ESG-related changes have been made to the UKRF's DGF?

There is compelling evidence that sustainable business practices lead to better investment decisions, mitigate risks, and, ultimately, create better outcomes for members. This is a belief that is firmly held by both the trustee and the investment management team of the UKRF. Hence, as our aim is to deliver the best possible overall outcomes for members, we are committed to taking action and the recent DGF changes reflect the implementation of this belief.

What we have done with the DGF, therefore, is to introduce enhanced ESG characteristics as additional investment criteria that will be used to screen investments. The screening process will identify material ESG risks and future growth opportunities. For example, it will reduce exposure to companies with high carbon emissions, or excessive executive pay and limited diversity and inclusion, while increasing investments in assets that conserve natural resources and businesses that integrate with communities in which they operate.

Why did you decide to integrate ESG and climate risk into the fund?

We made this change because we think it will have a positive impact on members' retirement savings in the long term. We expect that investments with improved ESG characteristics will face fewer risks and perform better in the long term compared to investments with weaker ESG characteristics and less focus on sustainable long-term practices.

Responsible investments have been on our radar for some time, as the UKRF signed the Principles for Responsible Investment (PRI) in 2015. In our view, ESG-related considerations are clear and present investment risks, and it has long been our view that these factors should not be afterthoughts, but rather actively considered in both strategic and day-to-day investment decisions. The changes to the DGF are an example of the progress we have made integrating the UKRF responsible investment policy into investment practices. We will continue integrating responsible investment considerations within the fund's strategic and day-to-day management processes and decision making, aiming for improved risk-adjusted returns over time.

What impact do you expect the integration will have on the fund's long-term performance?

We expect this integration to both reduce forward looking investment risks – through enhanced protection against ESG risks including climate change – and also lead to better investment returns and, hence, better risk-adjusted outcomes for members in the long term.

Market participants have become increasingly aware of and sensitive to ESG risks, and that will adversely affect assets and businesses with relatively weaker ESG characteristics and unclear plans to improve the sustainable aspects of their operating model.

How will this change the day-to-day management of the fund and trustee activities?

The DGF is a diversified multi-asset fund with wide-ranging underlying investments (multi-asset class, rather than equity focused only). The overall expected return and risk targets for the fund remain broadly unchanged, along with other key investment restrictions and guidelines under which we operate on a day-to-day basis. The focus of the investment process and portfolio construction on top-down macro risk factors (economic, inflation, real rates, credit, emerging and liquidity) is also preserved.

What changes is the bottom-up selection of the underlying investment assets, where ESG characteristics now sit alongside other investment criteria, such as market capitalisation, country, sector and currency, that are used when making decisions within the DGF portfolio. The DGF manager, BlackRock, will screen investments to identify material ESG risks, as well as future growth opportunities and be able to position portfolios accordingly. It will also continue to proactively engage with the entities and markets in which it invests on behalf of the trustee on a range of issues including voting, transparency on ESG risks, climate change and the transition to a lower carbon economy.

Do you see the move as part of a larger movement towards more ESG-friendly investments and, if so, what impact do you see it having on the investment landscape as a whole?

Absolutely. There are a huge number of macro-level debates underway in this space – and those are likely to intensify this year with COP26 and the increasing policy and regulatory focus on ESG and sustainability around the world.

The trustee and the investment team are actively involved in these debates, and collaborate with other asset owners (through the Institutional Investors Group on Climate Change, for instance) and our underlying investment managers to progress such considerations and contribute to the definition of best practice across ESG investments and sustainability. We see such idea sharing and contribution to emerging investment management frameworks as a key part of our fiduciary responsibility in managing the UKRF for the long-term benefit of members.

For our part, we are integrating ESG factors throughout the investment processes, while also focusing on active ownership, collaboration and appropriate disclosure. The changes to the DGF are part of that process, but it is not the only measure we have taken. Over the past few years, we have re-positioned some existing investments of the UKRF defined benefit (DB) scheme and established exposure in several new investments that have positive effects from an ESG perspective and clear focus on climate risk mitigation, including renewable energy and infrastructure.

Alongside the ESG and climate-related changes, are there any voting and stewardship-related changes planned?

Exercising voting rights is an important mechanism in the equity space and we are keen to use those voting rights and apply the principles of the UK Stewardship Code.

We are also building our active engagement on the credit side. This is important in the context of the DGF, a complex multi-asset fund, but also the DB scheme of the UKRF. With £35 billion in DB assets and a significant exposure in traded and private credit investments, we are committed to extending our stewardship and engagement responsibilities to material and long-term strategic holdings for the DB scheme. As such, the UKRF recently appointed EoS at Federated Hermes as a dedicated engagement specialist to maximise our influence as an active owner through proactive engagement (and voting, where applicable) with investee entities, regulators and markets within our DB scheme.

Written by Jack Gray