Summary

- Levels of ESG investing awareness varies between trustee boards. Larger boards may be more likely to show high levels of expertise and to develop detailed ESG strategies.
- There has been increased awareness of ESG through industry frameworks and the changing regulatory environment is putting pressure on trustees to deepen understanding of the long-term impact climate risks and opportunities will have on their schemes.
- Ongoing education to improve trustee understanding of ESG remains important.
- Increasing engagement and discussion about ESG issues is helping trustees to stay focused on the broader objective of decarbonising the planet alongside decarbonising individual portfolios.

ESG lessons

Andrew Williams explores the level of trustee training and education around ESG issues

Pension scheme trustees have an increasingly important role to play in attempts to tackle the impacts of climate change and improving sustainability. So, do pension scheme trustees have enough understanding of environmental, social and governance (ESG), sustainability and climate change investing issues to take on the task? Is further trustee 'upskilling' needed in this area?

Increased awareness

According to Pensions Management Institute director of policy and external affairs, Tim Middleton, trustee boards 'vary enormously' in terms of how well prepared they are to perform their duties. As a rule of thumb, he reveals that larger schemes will have a board that has access to extensive information training and bespoke training, and are also more likely to have one or more professional trustees appointed to the board.

"Such boards are therefore likely to show high levels of expertise and to develop detailed ESG strategies, and will have the confidence and expertise required to challenge their professional advisers when necessary. At the other end of the scale, smaller schemes are more likely to lack the resources associated with effective governance and so will be heavily reliant on their advisers," he says.

"Task Force on Climate-Related Financial Disclosures (TCFD) reporting has been required of schemes with assets in excess of £5 billion since October this year, and such schemes have managed very effectively. It is reasonable to suppose that such requirements will present a more serious challenge to smaller schemes when they are required to meet these reporting requirements from October next year," Middleton adds.

Elsewhere, LGIM head of client solutions, Laura Brown, has observed increased awareness of ESG through industry frameworks, which have "largely formalised the requirement to integrate ESG factors into investment decisions".

"The ever-evolving regulatory environment is putting pressure on pension scheme trustees to not only understand how to meet these changing regulations, but also the long-term impact climate risks and opportunities will have on their schemes. There is no doubt that building a better understanding of these issues is the latest challenge for pension scheme trustees – LGIM is talking about it with our clients in every trustee meeting," she says.

Applying pressure

TLT head of pensions, Sasha Butterworth, observes that ESG, a relatively new requirement for trustees, has gained a lot of traction in the past few years as regulation has ramped up – to the extent that many are now "much more astute and far more knowledgeable about the issues affecting pension schemes and how it impacts their members' lives".

"As a result of this, we're seeing more trustees and members using their voices to ramp up the pressure on the funds they invest in, ultimately trying to influence what companies are doing on ESG, sustainability and climate change," she says.

Butterworth also points out that this pressure on trustees is coming from all directions, with Millennial members particularly motivated by ESG issues and asking more questions about how their money is being invested. In addition, regulators are being more vocal about the need to consider ESG risks, with new mandatory reporting coming into force.

"We've even seen members bringing cases against trustee boards in Australia for breaching their fiduciary duties by not thinking about the risks that climate change poses to their investments," says Butterworth.

"There is a lot of confusion generally about ESG investing and what does and does not qualify as ESG. Some of this should be addressed by the work that's being done on the UK taxonomy and mandatory disclosures, but in the meantime, trustees need to ask the right questions and keep applying pressure on schemes to divulge what they're doing, and interrogate their claims. Just because something says it's an ESG investment, doesn't necessarily mean it is," she adds.

Regulatory duties

Meanwhile, Redington head of stewardship and sustainable investment strategy, Paul Lee, highlights the fact that trustees need to make decisions relating to a wide range of ESG and climate-aware investing issues – and must also meet the expectations set out in regulations, including the TCFD.

"So, they will need to be comfortable that they have the right understanding to enable them to take appropriately considered decisions. It has to be one of the roles of their investment consultants to help them reach that clarity of understanding, so that their decisions can be informed ones," he says.

For Lee, it also helps that The Pensions Regulator (TPR) has set an obligation for trustees to maintain and enhance their knowledge and understanding, in this area and generally.

"This helps frame a good deal of our current work, which is indeed about supporting trustees to understand TCFD and other forthcoming obligations. We have carried out education sessions for many boards on climate change and on ESG issues more broadly, and expect that to continue. What we tend to find is a great deal of engagement and interest, and a good deal of knowledge already in place," he adds.

Generally speaking, PTL managing director, Richard Butcher, thinks that trustees are aware of their duties in this area, which he describes as "extensive but manageable". That said, he doubts "anyone has enough understanding of the subject because it is so far reaching, complex and in many respects subjective".

"There is no common framework or even language. To trot out a tired cliché we are only at the start of this journey but at least we are making the first few steps," he says.

Butcher also believes that trustees need better knowledge in this area and observes this might be best achieved through a combination of outsourcing, fund manager guidance and official accreditation schemes.

"Trustees should bear in mind their own limitations, prejudices and preferences. Our job is to mitigate financial risks, it is not to make moral judgements. In this context it is almost a certainty they need to outsource some components of the function," he says.

Upskilling

When it comes to upskilling, Middleton points out that there is always a need to improve trustee education, and ongoing education to improve understanding of ESG is currently of particular importance. In recognition of this fact PMI has carried out extensive work in recent years to improve standards of trusteeship – largely in response to the demands of TPR for improved trusteeship standards. In Middleton's view, PMI's new Pension Trusteeship Diploma, whilst designed primarily for professional trustees, would be beneficial for any trustee seeking to demonstrate high levels of expertise.

"Accreditation is another option. It is important that trustees should develop sufficient expertise to be able to challenge their professional advisers, and this is more likely to happen if education is provided by a number of different sources. Trustees should also ensure that they have an ongoing education and training programme," he says.

"It is clear that those boards with an embedded approach to ongoing education and training develop trustees who are best equipped to address new governance challenges as and when they arise. PMI qualifications have an important part to play in the education of trustees, and we are committed to continuing to adapt our educational offering to meet the changing demands of the role," he adds.

Brown encourages trustees to draw on a variety of sources given the range of aspects to think about, "from setting objectives and impact on asset allocation to funding strategy and sponsor covenant through to manager selection, portfolio management and reporting". To improve awareness of ESG externally, LGIM has also been working with its clients and engaging with policy makers, index providers, peers and the wider industry through regular engagement, communications and training.

In-line with the messaging around COP26, Brown reveals that the company is also hearing more strongly from many trustees that they feel now is the time to take action – and a number of pension scheme clients have set net-zero targets and have then been working through a process to upskill on what this means in practice throughout their portfolios.

"There is a really interesting balancing act between a desire to cut carbon emissions up front and remain invested in higher carbon emitting companies that are critical to the transition to net zero – the 'should I stay or should I go?' debate. We believe the use of temperature alignment, which assesses each company's alignment with different temperature outcomes on a forward-looking basis, is a great innovation that helps bring this debate to life in meetings," says Brown.

"We have held lots of lively sessions with trustees on how to manage this balancing act – going forward, we expect to see much more specific engagement and discussion at meetings around individual companies, what they are doing and whether this is truly aligned with a net-zero objective. This is great news for ensuring that we stay focused on the real objective of decarbonising the world alongside decarbonising individual portfolios," she adds.

Written by Andrew Williams, a freelance journalist

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