Summary
• Trustees need to establish a clear set of beliefs, working with asset managers and consultants if necessary.
• Aligning those with asset managers' philosophies and practices requires careful analysis.
• Industry-wide collaboration is essential for developing consistent standards and good practice.
• Both qualitative and quantitative monitoring are important for ongoing assessment.

Better together

Building robust sustainable investment approaches needs collaboration between trustees, consultants, asset managers and the wider industry, says Maggie Williams

If a 'code red warning for humanity' from the United Nations isn't enough to convince the most sceptical trustee board that they should take sustainable investment seriously, robust reporting requirements and pressure from The Pensions Regulator mean they can no longer ignore climate-aware investment.

Sustainable investment practices are work-in-progress, however. Transparency, reporting quality, product offerings and long-term performance records are all still evolving. Trustee boards often also need help in defining a clear set of views, implementing them with investment managers and monitoring them over time.

MFS Investment Management global head of sustainability strategy, Vishal Hindocha, argues that an important first step is for trustees to have a clear definition of their scheme's beliefs. "Given the amount of uncertainty, ambiguity and complexity around sustainability, clarifying your own beliefs and approach is vital," he says, adding that this first step in the process is an ideal opportunity for schemes, consultants and investment managers to collaborate, share learnings and trade perspectives on different approaches. "Establishing beliefs is often a very rich, iterative and open exploration," he adds.

However, the extent to which schemes are able to define and implement sustainability beliefs may come down to time and knowledge. "Smaller schemes might have less resource and are often grappling with many other things alongside stewardship. They may not be able to give stewardship as much attention and will perhaps be more reliant on their consultant," says Pensions and Lifetime Savings Association (PLSA) deputy director of policy, Joe Dabrowski.

Even for larger schemes, the drivers for investing sustainably may vary. "There can be myriad motivations and reasons why a scheme may wish to pursue sustainable investing, some of which may necessitate or justify different methods of implementation," says Hindocha.

However, asset managers, too, may struggle to match the views of all their

Case study - Railpen
Railpen senior investment manager for active ownership, Caroline Escott

"The Railpen team works hard to monitor and assess our external managers' approach to responsible investment. We have recently updated our manager assessment framework to better understand the extent to which a manager's approach aligns with our own. Where we would like to see the manager go further, we will seek to hold a constructive discussion. A key issue for us is trying to cut through glossy sustainability reports to get to the heart of what a manager is really doing on issues which are material to Railpen. Some approaches we use are:

• **Be clear about the issues that matter to you and are material for your portfolio.** These should be documented in your Statement of Investment Principles and/or elsewhere. Where possible, these expectations should be made clear in your Investment Management Agreement or other legal documents such as side letters.
• **Make the most of key opportunities for influence with your asset managers.** Although regular engagement with the manager throughout the year is helpful for building a productive and trusting relationship, manager selection and formal manager reviews can be powerful moments for influencing managers' behaviour on material ESG issues and priorities.
• **Set the agenda for conversations with managers.** Schemes should make sure managers provide specific case studies or examples of activity on the trustees' priority issues. The best questions will help trustees to understand how thoughtful a manager's approach to responsible investment is. What examples can they give of engagements which did not achieve the desired objectives and what lessons have been learned?

clients. “They may have tens of thousands of clients, all of which will have a mix of different views. Voting in blocks, might contradict each other, can also be difficult,” adds Dabrowski.

“We believe genuine alignment is crucial for success,” Hindocha explains. “This involves understanding whether your manager is aligned with your approach and how sustainability is factored into the manager’s investment process.”

Despite the challenges for both schemes and asset managers, Redington senior vice president, responsible investment, Edwin Whitehead, says that finding common ground is vital. “Pension schemes are ceding some control over their investment activity to asset managers, so it’s important there is alignment *[in beliefs]* between the two.”

Aon associate partner, Jennifer O’Neil, says that schemes need to rigorously test this alignment. “While an asset manager’s philosophy may be aligned, do they act as effective and proactive stewards of capital? Do they integrate environmental, social, and governance-related risks and opportunities into their investment process?

“For a trustee board, this assessment can be opaque, so judicious assessment of credibility and capability which looks ‘under the bonnet’ is something that many schemes look to third parties – such as their consultant – to help with.”

Delving into the detail of asset manager’s stewardship processes is vital as trustees report on how they have addressed ESG objectives and beliefs in their Implementation Statement. “Implementation Statements haven’t got off to a great start,” admits Whitehead. “Some schemes are just articulating what their managers have told them. But managers also sometimes don’t frame or report in the client’s individual context. Consultants will need to help able to hold asset managers to account.”

Defining beliefs and aligning them with investment managers is just the start, adds O’Neill. “The key message for trustees is not to take a ‘set and forget’ approach to either their collective beliefs, or to the assessment of their managers against those beliefs.”

She advises taking both a qualitative and quantitative approach to holding mangers to account. “One without the other gives an incomplete perspective: for instance, looking only at voting statistics without considering qualitative engagement activity and outcomes won’t help a trustee board assess alignment or direction.”

Hindocha agrees: “Qualitative assessment is necessary, given the nature of sustainability and that many areas of ESG data and metrics are still developing.”

Whitehead also emphasises the importance of “reporting in the client context, not just playing back good news stories. Different schemes are going to care about different things. Climate change is a major focus, but social issues are also coming to the fore.”

The process of holding managers to account is just one of the ways in which reporting, stewardship and engagement will improve over time across the investment industry.

The Financial Reporting Council’s rejection of one-third of signatory applications for its 2021 Stewardship Code is a stark illustration of tougher standards and an unwillingness to wave through practices that lack transparency or pay lip service to ESG factors.

Asset managers, consultants, pension schemes and industry bodies are also collaborating to improve standards, in what Dabrowski concedes is “a busy space addressing some fundamental challenges”. The Occupational Pensions Stewardship Council, set up by the government, the Investment Consultants Sustainability Working Group within the consultant community, and a joint initiative between the PLSA and Investment Association to address systemic issues in sustainable investment are three of the current initiatives.

While there are many areas for improvement in sustainable investment practice, climate change itself will not wait for debates over reporting standards or data management to be solved. Trustees, asset managers and their advisers need to continue to act now on their own initiative. Focusing on overcoming current challenges and committing to invest sustainably is not just best practice, it is a code red imperative.

Written by Maggie Williams, a freelance journalist

In association with

Establishing beliefs

MFS Investment Management global head of sustainability strategy, Vishal Hindocha, gives trustees some questions to ask when agreeing on investment beliefs

- **Motivation:** What are the main reasons that are we interested in sustainable investing?
- **Objective:** Is this a tick-box exercise? Are we interested in “greening” our portfolios or the real economy?
- **Alignment:** What is our time horizon? How do we define our agency? How does this fit in our fiduciary capacity and meet our stakeholders’ needs?
- **Strategy:** What is the most effective way for us to achieve our objective?
- **Tactics:** How do we hold ourselves and our stakeholders/service providers accountable? What are some of the short-term issues we need to better understand? Are there particular areas that we can hone in on to provide focus and a means of getting started on the journey?