Cutting through the noise

Abigail Williams considers how to monitor the ESG impact of investments

Summary

- Many pension schemes are increasingly focused on improving strategies used to monitor and evaluate the ESG impact of investments.
- Some observers suggest that more substantive progress in this area is only attainable when fund managers move beyond tick-boxes and link ESG impact data to actual real-world outcomes.
- There are also indications that trustees may need to push for more evidence to substantiate ESG impact claims – and remain consistently alive to the risks of corporate greenwashing.

Despite signs of a growing global backlash against ESG investments, many UK pension funds remain committed to improving the sustainability performance of their portfolios. Against this background, schemes are now increasingly focused on improving the strategies they use to monitor and evaluate the ESG impact of investments. So, what types of methods they typically use for these efforts? How might pension scheme managers' understandings, attitudes and actions be influenced by the way this data is collected and interpreted? And how might these interactions affect the risk of corporate greenwashing?

Beyond tickboxes

According to Pensions for Purpose director, community, Laasya Shekaran, pension funds generally track ESG through ratings, impact reports and stewardship results, but "the real progress comes when they move beyond tick-boxes and link data to actual outcomes".

"Before appointing a mandate, pension fund trustees should consider what the intended ESG impact of the mandate is. This will affect how to monitor the success of the ESG impact. It may be something that can be measured via quantitative data and metrics, or it may require qualitative information and case studies," she says.

Scottish Widows head of responsible investment, Eva Cairns, agrees that, in order to truly measure impact, fund managers would need to go one step further "and actually measure impact on the desired outcomes". For example, by measuring emissions avoided or reduced through products, or how many people have been provided with access to education or healthcare.

"This year we evolved our approach by integrating alignment metrics and Sustainable Development Goal (SDG)-related metrics into our workplace pensions default. We are also using SDG frameworks developed by our partners to understand the impact our companies have on the SDGs based on their operations, products and services," she says.

"We believe that positive societal and environmental impact can be increased and delivered more directly through private markets, where the direct impact of certain assets such as green infrastructure are assessed as part of the business case for the investment and ongoing monitoring," Cairns adds.

A layer deeper

According to Baillie Gifford investment specialist, Nduka Amadi, a variety of methods are used to monitor impact, typically involving a third-party platform with a quantitative or negative screening-based approach. In contrast the company's Positive Change Fund adopts what he describes as a "bottom-up, qualitative approach to impact investing".

Meanwhile, Isio head of sustainable investment, Cadi Thomas, observes that the main focus for trustees and pension fund managers, particularly within the DB pensions space, has been on improving standards of ESG integration throughout the portfolio, rather than making impact investments. For DC and LGPS clients, she notes the approach is slightly different "as schemes are not as limited by risk concerns or liquidity constraints, so impact investing is more common here".

"Typically, we see trustees evaluate their scheme's ESG impact through the asset manager's sustainability reporting and assessments, the quality of which varies from manager to manager. This highlights the need for the in-house team, or consultants, or another party, to bring various information together via a consistent framework across managers," she says.

"In order to accurately assess the impact a scheme's investments are having, we see a need to go a layer deeper and look at case studies the manager can provide where an investment has made a positive, real-world impact. We feel that this is a more hands-on approach to monitoring ESG impact, as you can then see directly the change a scheme's investments are having in practice, rather than viewing impact at a top-down level through ESG reporting," she says.

Demanding better disclosure

According to Thomas, a key challenge in the impact reporting space is how specific portfolio company information is aggregated to portfolio level.

"Given individual companies will be targeting different impact themes, the metrics KPIs for each portfolio company will differ as they will be aligned to the specific impact theme. We therefore see challenges surrounding portfolio level impact metrics reporting," she says.

Thomas also highlights increasing pressure from institutional investors on asset managers to produce more accurate, consistent and thorough ESG reporting. A key challenge here lies in ensuring sufficient coverage of ESG data on metrics that trustees care about, for example, carbon footprint for TCFD purposes.

"There are a number of ESG data providers in the market, which can lead to discrepancies in results and methodologies, leading to potentially unfair comparisons. We hope that by standardising reporting requirements, ESG impact disclosure and reporting will improve over time," she adds.

Shekaran observes that data varies a lot depending on the asset class, geography and ESG theme, although "generally there have been improvements in data".

"The best managers cut through the noise by demanding better disclosure, using independent checks and engaging directly with companies. Asset managers and asset owners should be aware of the limitations of quantitative data, both in terms of data quality, and the ability to capture the full story, and should supplement data with narratives and case studies," she says.

Avoiding greenwashing

For Cairns, another key point to note is that ESG data needs to be interpreted carefully to avoid overstating impact and what difference the investor has made. She also stresses that it is "important to be mindful of the FCA's anti-greenwashing rules, and take the same approach as with qualitative statements and claims".

"The rules state that claims need to be fair, clear, not misleading and capable of substantiation. These principles should be applied to how ESG-related data is used, just as they're applied to any other claims made about our ESG impacts," she says.

"Given trustees need to rely on the data provided and methods used by managers when making investment decisions and regulatory disclosures, they need to ensure they're alive to the risks of greenwashing"

"We need to differentiate between providing transparency on ESG metrics associated with pension investments and mapping activities to certain SDGs. Then we can understand how they link to real world outcomes," Cairns adds.

Thomas thinks trustees should also probe asset managers for case studies on how their investments have had a material environmental or social impact.

"The trustee can then take a holistic view of a scheme's investments by having a broader view of the impact the scheme is having," she says.

"In terms of greenwashing, we feel it is critical to consider reporting capabilities, but also assess other criteria when evaluating an investment manager's ESG capabilities. For each product we assess, including impact solutions, we assess a number of criteria across investment approach, risk management, stewardship, reporting and collaboration," Thomas adds.

Ultimately, Burges Salmon senior associate, Jack Gillions, observes that the methods used to monitor ESG impact data and the quality of that data "will all influence the robustness of investment decisions and the assessment of climate-related risks and opportunities". Where the data used follows standardised frameworks, like TCFD, FCA anti-greenwashing rules and Sustainability Disclosure Requirements, he believes this should help trustees to meet their own fiduciary duties and effectively understand and compare ESG impact data.

"Given trustees need to rely on the data provided and methods used by managers when making investment decisions and regulatory disclosures, they need to ensure they're alive to the risks of greenwashing," he says.

In doing so, Gillions urges trustees to ensure managers and consultants are using good quality data and methods to monitor data, for example through effective scrutiny and interrogation of ESG impact data reporting and the methods used by managers.

"Where investment managers provide only limited data on the methods used to assess impact data or promotional claims are made about sustainability characteristics with limited evidence, trustees may want to push for more evidence to substantiate those claims," he says.

"Trustees should review their contractual terms with their fund managers, understand how managers are monitored and their reporting requirements. Undertaking introductory training on ESG disclosures and the potential risks of greenwashing may also be helpful," Gillions adds.

Written by Abigail Williams, a freelance journalist