Sustainability in defined contribution

Sam Tripuranen explores how to implement long-term sustainable investing within defined contribution funds

Amidst all the responses to the crisis, it has not gone unnoticed to me that we're witnessing an increased interest in sustainable investing amongst UK pensions investors *[Source: BlackRock DC Pulse 2021]*.

For someone working in sustainable investing, Covid-19 has inadvertently given me the chance to step back and look at environmental, social and governance (ESG) with fresh eyes. We have also noticed that our collective increased scrutiny of how companies have been treating and interacting with their workforce during the crisis – allowing us to reflect on 'purpose' and the little brother in the room – the 'S'.

However, I want the conversation to move away from the well-trodden 'what ESG methodology' should a UK DC scheme use. What to me would be more pertinent to focus on are the considerations around long-term investing.

The time is nigh – how to do it?

At BlackRock we believe that investors should choose ESG when they believe it will deliver better risk adjusted returns over the long term.

The Department for Work and Pensions (DWP) requirements for the consideration of non-financial material factors has driven the need for the consideration of what trustee's believe are E, S and G risks and opportunities in their portfolios.

Sustainable funds have now had their first market crisis with which to score them – and crucially, for the most part, have performed as we expected them to – i.e. they have demonstrated a resilience akin to the quality and minimum volatility factors we have long known and have had a positive correlation to ESG ratings.

There is, of course, a cost implication to moving allocations. This is where having conviction in ESG is important – why pay more if you don't believe in ESG or at the very least if your members are not asking for it? The DWP are certainly not forcing it (yet!).

What we have seen over this cycle is that additional cost may be rewarded in performance (or through minimising the downside). When you take the longer-term horizon of DC members in growth phases, more and more of these E, S and G risks begin to manifest.

My suggestion to investors is for them to consider if they believe that E, S and G risks are material enough for them to do something about it.

Allocation through contributions

can reduce cost and ESG can pay for itself through performance, if investors are willing to consider the long term. It is with a simple investment premise of understanding the materiality of E, S and G risks that BlackRock are dedicating our research to.

We believe that in these extraordinary times, there will be change and, if now is the time to invest in ESG, then we can help our clients navigate that change as smoothly as possible.

Written by BlackRock Sustainable Investing team EMEA member, Sam Tripuraneni