



Environmental



Social



Governance

ESG: yesterday,
today, and tomorrow

We'd like to thank...

REDINGTON



For sponsoring this report

Welcome from hosts

Jonathan Parker
Director, Redington

Chair's welcome

Catherine Howarth,
CEO, Share Action

Chris Curry

*Director,
Pensions Policy Institute*

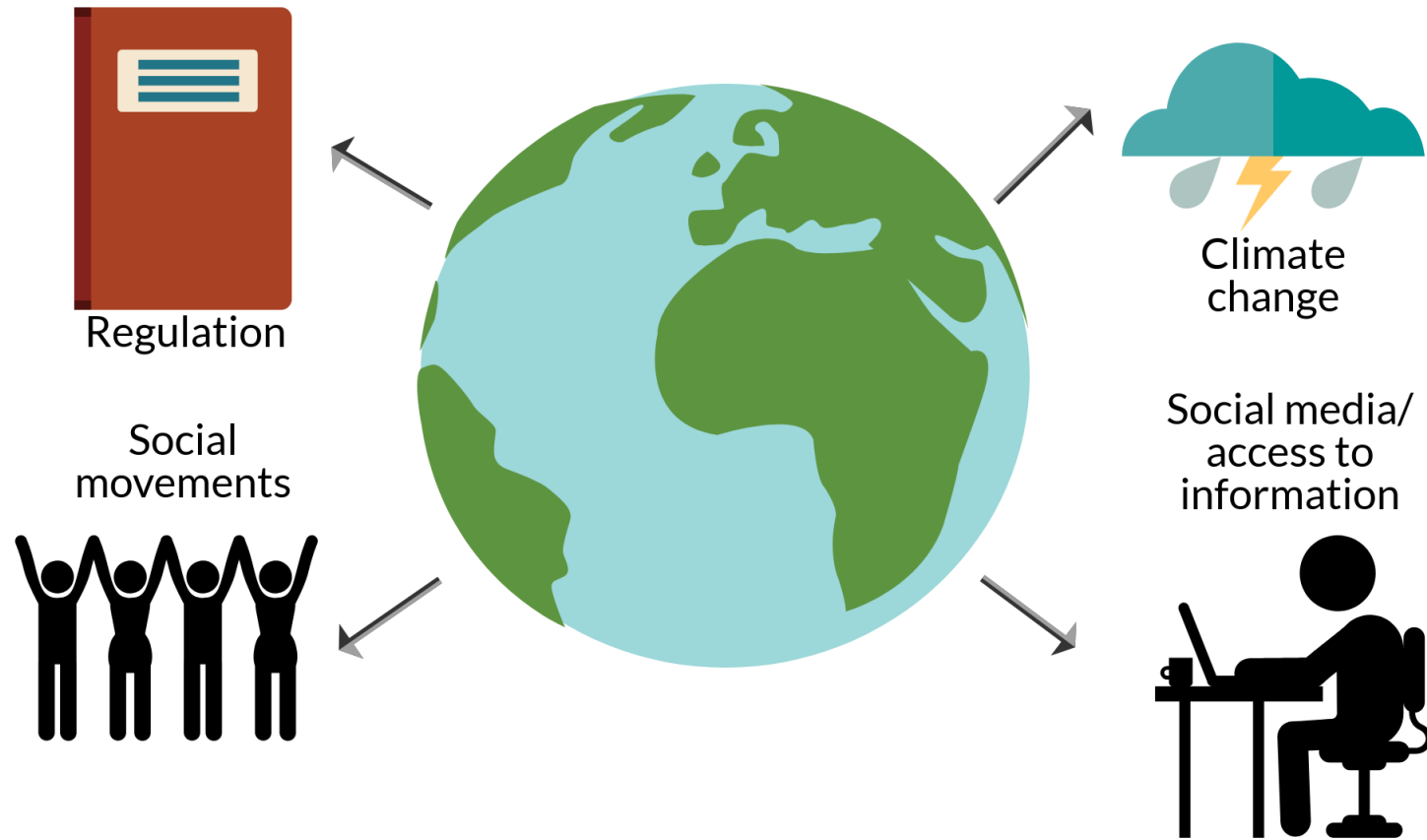
ESG: past, present and future

- The world is changing, and approaches to investment are changing alongside it
- There is a lack of consensus regarding the definition and impact of ESG factors
- The Government has laid regulations which strengthen the obligation on pension scheme trustees
- Pension schemes who do not integrate ESG consideration into their investment strategy could face legal difficulties, higher costs or reduced returns
- However, there are barriers to ESG integration

The world is changing

PENSIONS POLICY INSTITUTE

PPI



Investment approaches are changing

- Proponents of ESG argue that a strong case has been made for better returns and sustainability.
- Pressure is growing from regulatory bodies, members, investment managers and activists to consider ESG factors in investment strategies
- The explicit consideration of ESG factors in UK scheme investment decisions is currently low.
- But a growing number of pension schemes are integrating ESG factors into their investment decisions or planning to do so in the near future.

A growing number of schemes are integrating ESG factors



NEST



The
People's
Pension



HSBC



Brunel
LGPS

How can ESG factors affect returns?

Environmental factors:

- Resource depletion, including water waste and pollution;
- Air pollution; and
- Deforestation.

Risks include:

- Poor environmental practices leading to depletion of resources, and/or hindering production and development; and
- Reputational risk.

Social Factors:

- Working conditions, including slavery and child labour;
- Health and safety;
- Employee relations;
- Diversity;
- Social unrest; and
- Income inequality.

Risks include:

- Reputational risk;
- Poor productivity; and
- Potential for legal difficulties (fines, sanctions, being forced to close or change).

Governance factors:

- Executive pay;
- Bribery and corruption;
- Board diversity, structure and culture.

Risks include:

- Some stakeholders being prioritised over others and/or disaffected;
- Poor strategic and operational decision-making; and
- Legal and regulatory risks.

There is some confusion as to the purpose and definition of ESG

- ESG is sometimes seen as:
 - a shorthand for assessing potential risks to investment sustainability
 - a distraction
 - detrimental to scheme goals
- The Law Commission has attributed this to:
 - the conflation of ESG with “ethics”
 - a lack of clarity as to whether there is a requirement to take factors into account which will not impact the scheme financially.

There is some confusion as to the purpose and definition of ESG

...a handy acronym to capture a wide range of potential sources of risk to return or reputation (DB Scheme Investment Manager)

...a distraction from the goal of delivering long term returns (some reported views of DB scheme trustees)

... about recognising that companies cannot get away with doing the wrong thing forever and that eventually there will be financial implications (Asset Manager).

...all about ethics ...just for hippies
...lunch is for wimps
(some reported views of DB and DC providers)

ESG assessments are not straightforward

Though there are companies which provide ratings, there are factors which can make ESG assessments difficult such as:

- a lack of consistency in reporting
- a lack of information on smaller companies leading to larger companies having higher ESG ratings
- a lack of standardisation in disclosure rules
- risk assessments tend to be done on a sector-wide basis, and can ignore within sector differences.

The Government has laid regulations which strengthen the obligation on pension scheme trustees

- Regulations for trustees, to be implemented by 1st October 2019, to set out:
- how they take account of **financially material considerations**, including (but not limited to) ESG considerations, including climate change;
- their policies in relation to the stewardship of investments, including engagement with investee firms and the exercise of the voting rights associated with investments;
- the extent (if at all) to which non-financial matters are taken into account in the selection, retention and realisation of investments.

The Government has laid regulations which strengthen the obligation on pension scheme trustees

PENSIONS POLICY INSTITUTE

PPI

- For trust-based schemes providing DC benefits:
- to publish their Statement of Investment Principles on a website so that it can be found and read by both scheme members and interested members of the public, and inform scheme members of its availability via the annual benefit statement;
- in relation to the default arrangement, to prepare or update their default strategy to set out: how they take account of **financially material** considerations, including (but not limited to) ESG considerations, including climate change

The Government has laid regulations which strengthen the obligation on pension scheme trustees

- Regulations for trustees of DC schemes with 100 or more members, to be implemented by 1st October 2020:
- publish an online implementation report setting out how they acted on the principles in their SIP.

There may be consequences for schemes who do not take ESG factors into account

- Pension schemes who do not start to integrate ESG consideration into their investment strategy could face:
- legal difficulties as a result of not complying with regulations,
- higher admin costs, if they need to adapt practices quickly in order to comply with regulations,
- legal costs if they don't comply in time,
- and potentially reduced returns in the future as a result of not taking financially material risks into account.

There are some barriers to ESG integration

- Pressurised trustees are often resistant to adding more factors, especially when they are sceptical regarding the potential benefits.
- Smaller schemes in particular may not have the resources to bring control of their detailed investment strategy in-house
- Not all asset managers offer investment funds which integrate consideration of ESG factors.
- There is confusion among Trustees and IGCs as to the definition of ESG, and the assessment and integration of ESG factors in investing is not straightforward.

Conclusions

- If consideration of ESG factors was built into asset manager benchmarking, there may be more motivation to consider these.
- If more products that involve ESG consideration were available to small schemes, they would find it easier to invest in companies with better ESG credentials.
- Trustees and IGCs could benefit from more concrete guidance and support.
- Smaller schemes may also need more support around consolidation of assets and/or investment administration, in order to make consideration of ESG factors easier.

David Farrar

*Senior Policy Manager,
Department for Work and Pensions*

Taxonomy of approaches

Responsible Investment

Ethical investing: using ethical principles as the primary filter for choosing where to invest

ESG: investing which takes into account financial risks posed by environmental, social and governance factors

Green investing: investing in companies focussed on conserving natural resources or working on clean air and water initiatives, alternative energy sources and other environmental projects

Sustainable investment: a broad term, often considered synonymous with ESG, meaning investing in assets which are judged to be able to deliver long-term competitive returns and positive social impact.

Social impact investment: investments made with the intention of generating a positive social impact alongside a financial return

Misperceptions

- “[Trustees] also consider ESG (Environmental, Social and Corporate Governance factors) and external governance reviews to be low priorities. Some participants were not sure what ESG meant... Some see ESG as a distraction or potentially detrimental to achieving the scheme’s goals.”
- “Climate risk is undoubtedly a risk, but we have no idea what we should do to reduce that risk. Until this becomes clearer, we believe the only logical thing to do is to ignore it.”
- “The concept of global warming was created by and for the Chinese in order to make U.S. manufacturing non-competitive.”

Trustees' Duties

All benefits are money purchase ('pure DC')	C	B + C + D
Mix of non-money purchase and money purchase from sources other than AVCs ('dual section')	C	B + C + D
Non-money purchase apart from AVCs ('almost pure DB')	A	B
Wholly non-money purchase ('pure DB')	A	B
	Less than 100	100 More than 100
	Number of Members	

A

No new requirements

B

By 1 October 2019 - Update policies on financially-material considerations, stewardship and non-financial matters.

C

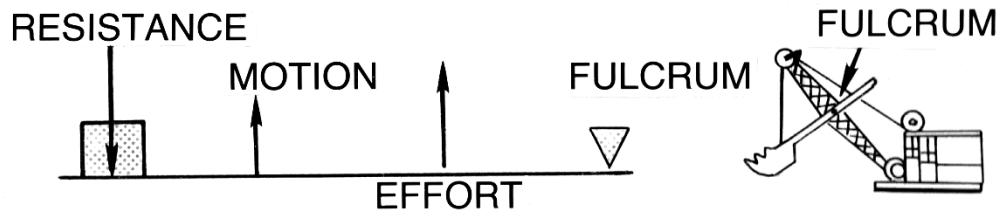
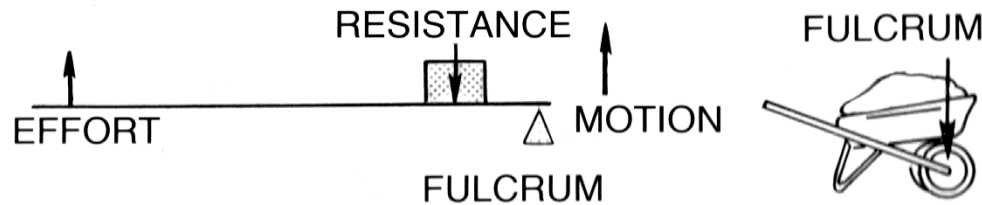
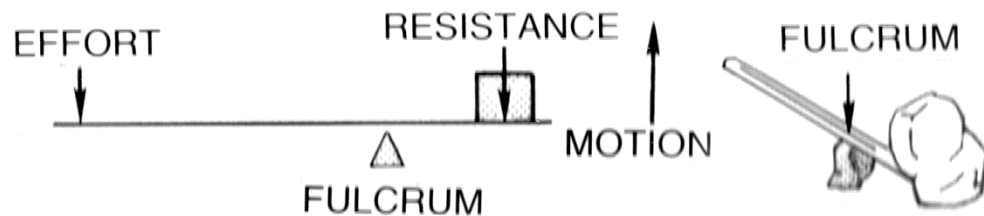
By 1 October 2019 - Update default investment strategy to take account of financially-material considerations and any policy on non-financial matters.

D

By 1 October 2019 – Update default investment strategy to take account of policy on stewardship, and publish Statement of Investment Principles
From 1 October 2020 – Produce and publish implementation statement.

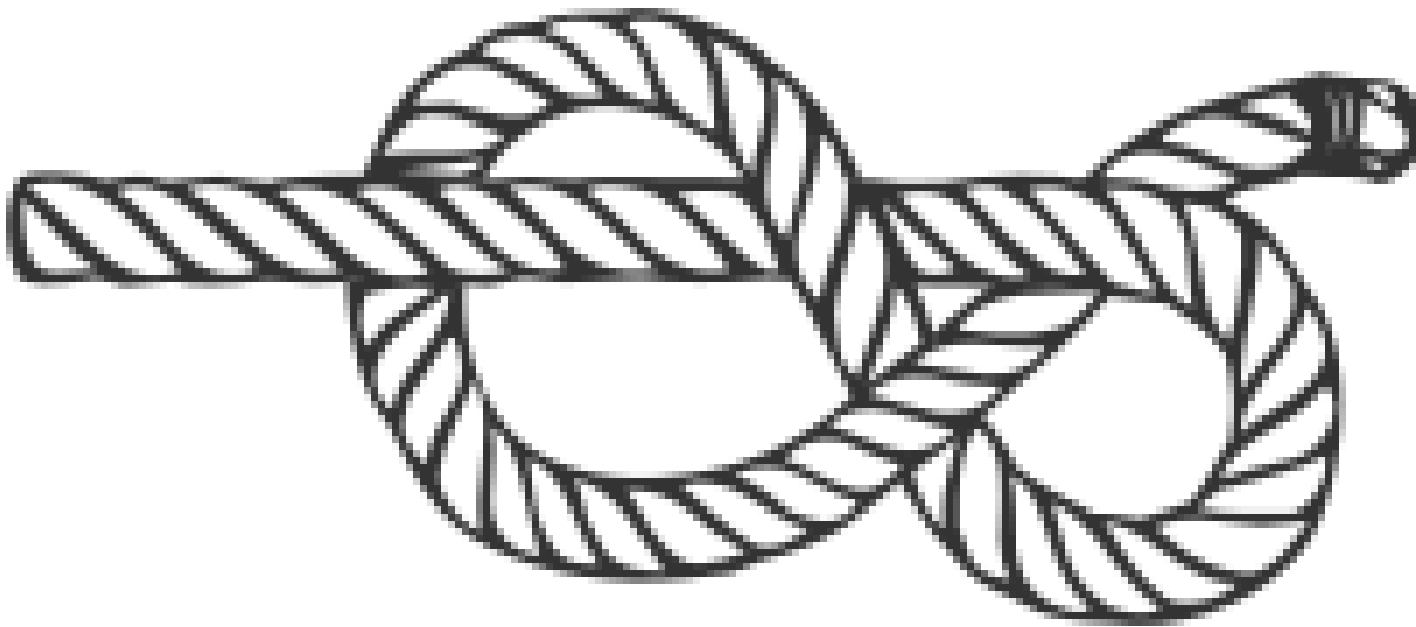
Box ticking and Complexity 1

- Transparency as a lever?



Box ticking and complexity 2

- Easier with consolidation



The next steps

- DC and DB will continue to be different
- The purpose of the trust – always an appropriate return?
- Can quality of life be financialised?
- Fiduciary duty may continue to evolve

HM Treasury Green book

PENSIONS POLICY INSTITUTE

PPI

Market prices

Prices from the relevant market (excluding taxes and subsidies). In some cases a closely comparable market can be used where a direct market price is unavailable.

Generic prices

Use of a Green Book approved transferable price applicable to the proposal.

Revealed preference

Techniques which involve inferring the implicit price placed on a good by consumers by examining their behaviour in a similar or related market. Hedonic pricing is an example of this where econometric techniques are used to estimate values from existing data.

Stated preference willingness to pay

Research study by professionally designed questionnaire eliciting willingness to pay to receive or avoid an outcome.

Stated preference willingness to accept

Research study by professionally designed questionnaire eliciting compensation to accept a loss.

Wellbeing

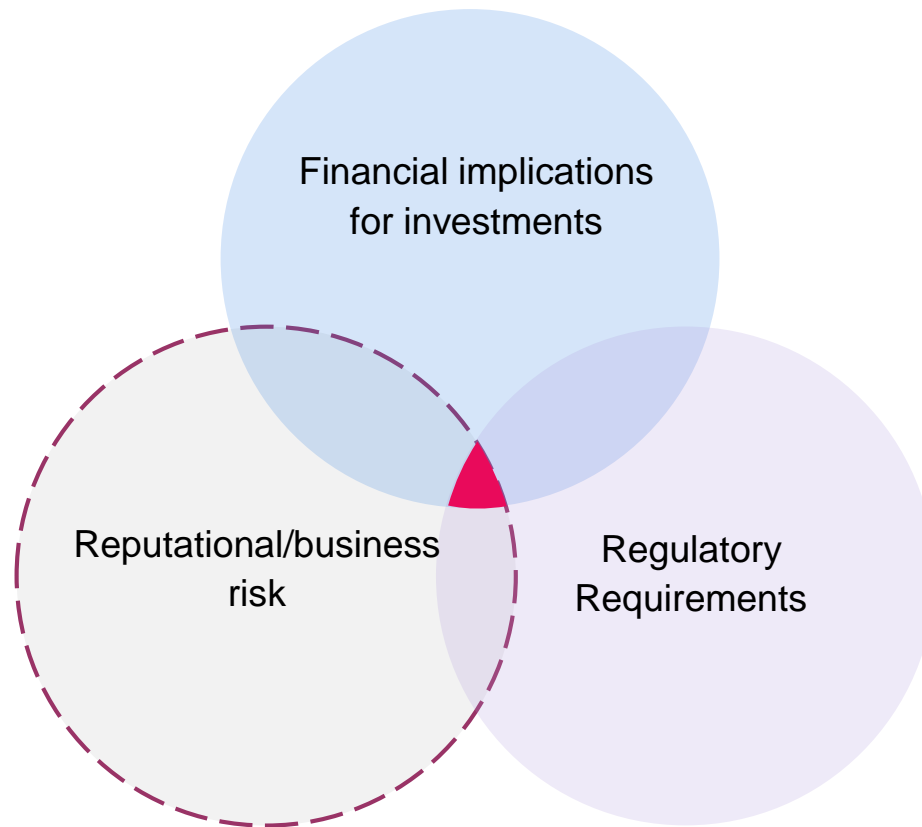
Use of direct wellbeing based responses (in existing data or from research by questionnaire) to estimate relative prices of non-market goods.

Estimation of a central reference value and a range

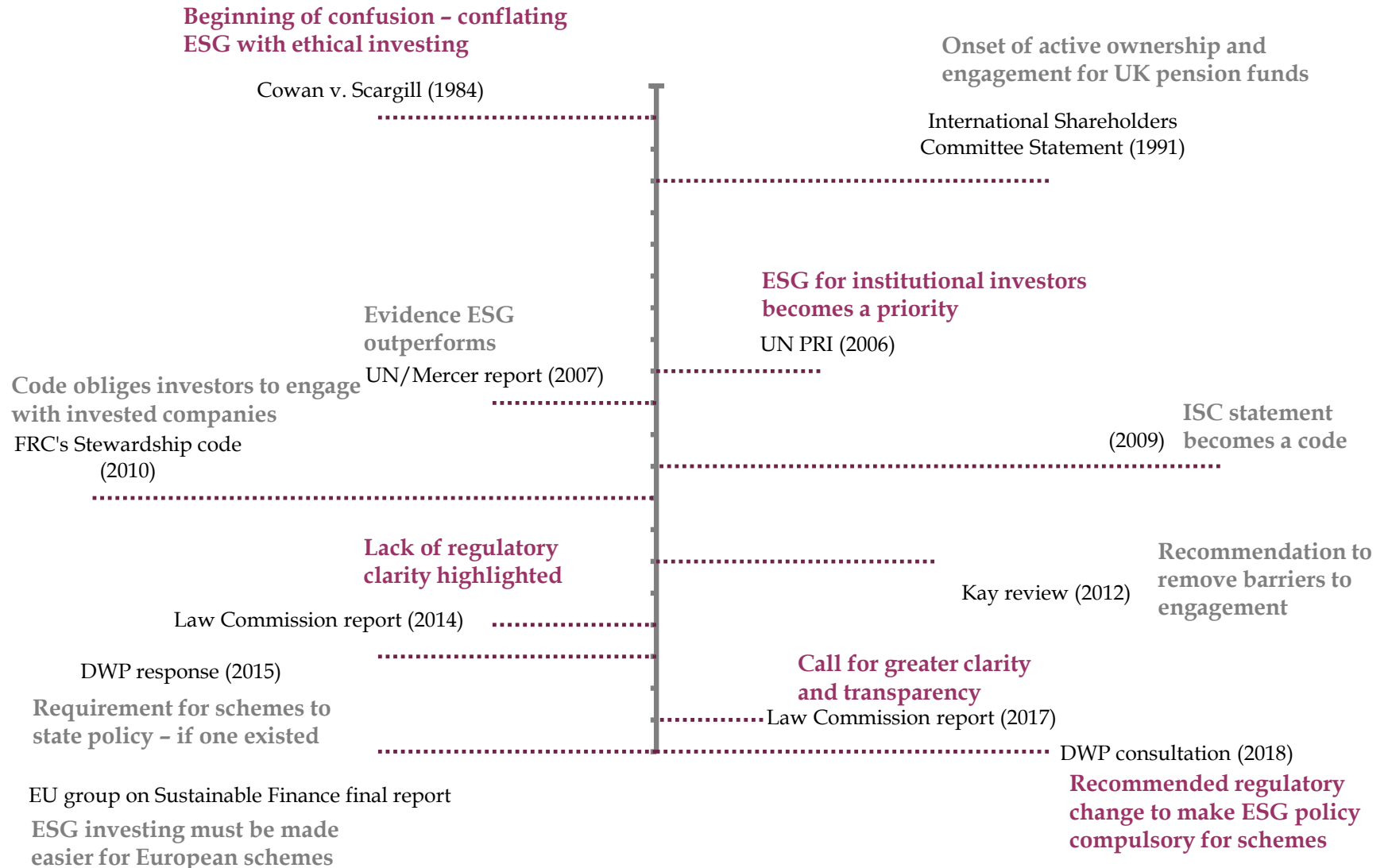
Based on available data.

Honor Fell

Vice President, Redington

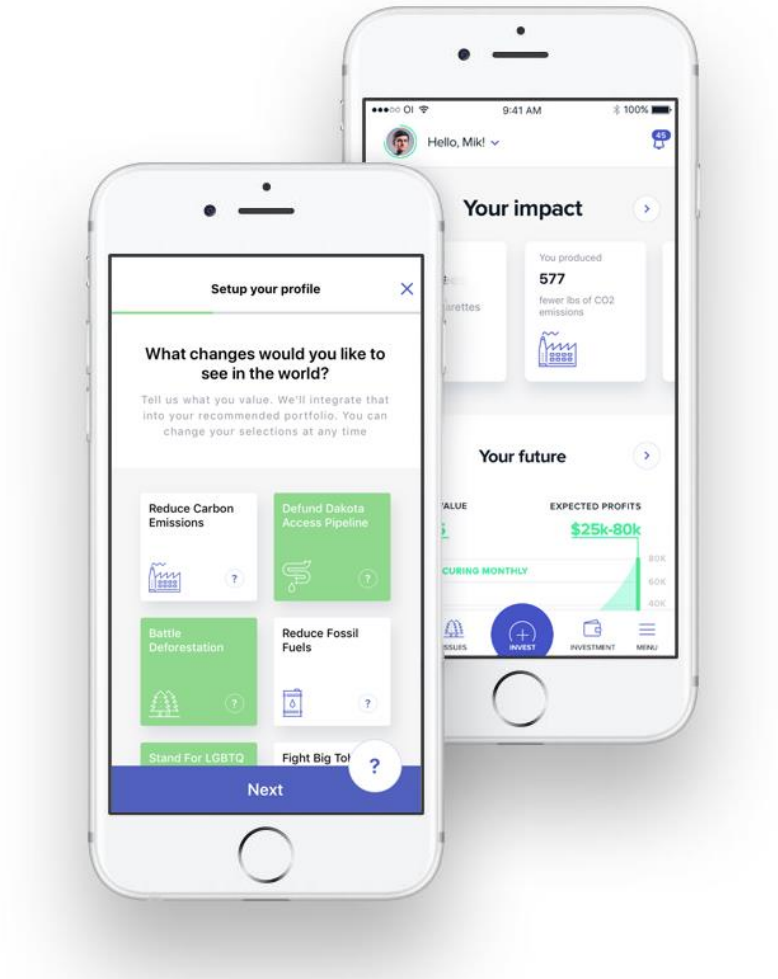


Growth of ESG regulation



Passing trend? Or here to stay?

- Data availability
- Environmental changes
- Technology



Are we at a tipping point?

PENSIONS POLICY INSTITUTE
PPI



What can consultants do?

- Consistent and clear definitions
- Share the 'art of the possible'
- Use decision making frameworks to guide clear actions & objectives

Investment
Beliefs

Strategic asset
allocation

Fund Ratings

Reporting

What's your ESG 'persona'?

Comply

Measure and manage

Seek Alpha

External Impact



**"We comply
with the
regulations"**



**"We monitor
and engage
with ESG
issues"**



**"We seek
opportunities
in ESG to take
advantage of"**



**"We target
impactful
outcomes in
ESG"**

*ESG is a risk factor that
should be managed*

*ESG is a source of
financial benefits*

*ESG is a source of extra non-
financial benefits*

CONTROL THE OUTCOME

measure the risk

REDINGTON



ESG INVESTMENT PRINCIPLE 12

Risks still exist if you don't measure them, but risks can only be controlled if you do measure them.

Panel Discussion

Pensions Policy Institute

PPI

Nico Aspinall
B&CE

David Farrar
Department for Work and Pensions

Chris Curry
Pensions Policy Institute

Lydia Fearn
Redington

Ruston Smith
Tesco

Chatham House Rule Applies

Questions And Answers

Chatham House Rule Applies

Closing remarks

Chatham House Rule Applies

REDINGTON



PENSIONS POLICY INSTITUTE
PPI

Thank you for attending...

Please join us for drinks and networking