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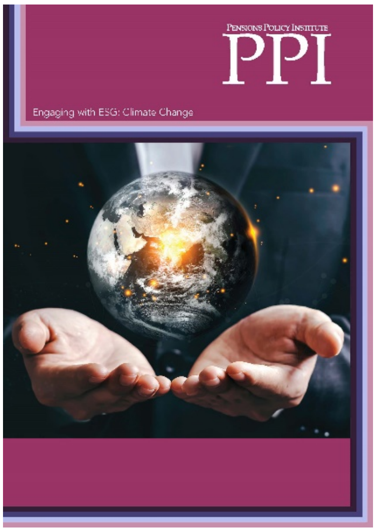
PPI Policy Launch Event
Engaging with ESG: Climate Change

Launch write up:



The Pensions Policy Institute (PPI) held a policy seminar on 18 February 2021 to launch Engaging With ESG: Climate Change, sponsored by **Phoenix Group, Gold Supporting Members of the PPI.** This report is the second output in the Engaging with ESG series. It explores the attitudes and approaches currently being implemented in relation to climate change, with the aim of highlighting areas where further support, guidance or intervention could be beneficial in order to improve engagement and implementation of appropriate risk management.

The Engaging with ESG series is sponsored by, Newton Investment Management, Phoenix Group, Association of British Insurers, Baker McKenzie, PLSA and Scottish Widows.

The event was run as an online seminar with the key findings presented by the author Lauren Wilkinson (PPI), responses from the sponsor Michael Eakins (Phoenix Investment Group), and responses from the panel, David Fairs (The Pensions Regulator), Gareth Trainor and Sindhu Krishna (Phoenix Group), Andrew Parry (Newton Investment Management), Maria Nazarova-Doyle (Scottish Widows) and Dr Yvonne Braun (ABI).

Over 85 people representing a broad range of interests within Government, the investment industry, the pensions industry and the third sector attended the seminar. Chris Curry (PPI) chaired the event.

Presentation of key findings and responses to the report

Chris Curry, Director, PPI, welcomed the attendees to the event and thanked the report sponsor, Phoenix Group, as well as other series sponsors, Newton Investment Management, ABI, Baker McKenzie, PLSA and Scottish Widows for their support. He introduced the report as the second in a series of ESG work underway within the PPI, and discussed its importance in the context of developments in legislation, policies and trustee or provider engagement with risks associated with ESG.

Lee Massey, Fundraising and Events Assistant, PPI, introduced the panel and participants to the online format of the event.

Michael Eakins, Chief Investment Officer and Group Executive Committee Member, Phoenix Group, welcomed attendees to the launch event and thanked the team at the PPI for their hard work in producing this report. He discussed the commitment of the Phoenix Group to the growing importance of ESG and the responsibility that every industry has to play in creating a tide of change. Specifically, he anticipated that long-term climate change is likely to become a defining issue for members and cautioned that the way in which peoples' money is invested will have a significant impact on what future generations will inherit. He concluded that one of the most important findings from the report is the need for continued collaboration from industry, government, industry, funds and consumers to achieving these goals.

Lauren Wilkinson, Senior Policy Researcher, PPI, presented the key findings from the report. She highlighted that the financial implications of climate change are becoming increasingly important in scheme investment decisions. Although some schemes are actively trying to engage with their members on climate change, only a low proportion of members are interacting with their pensions and their involvement in climate change strategies is very limited at present. The report addresses three key questions which schemes are encouraged to consider:

1) How they are approaching climate change (in contrast to other areas of ESG)
2) The role of members in climate change approaches and how this might develop, and
3) Practical steps to overcoming barriers relating to climate change investments.

Joined-up goals, strategies and data sources across government and industry will improve scheme engagement with climate change and help with overcoming barriers relating to climate change investments. They include:

- Integrated goals
- Engagement and stewardship
- Encouraging innovation from third parties
- Increasing knowledge and understanding
- Standardising data and terminology

David Fairs, Executive Director Regulatory Policy Analysis & Advice, and PPI Governor, thanked the PPI and Lauren for the work, and reiterated the importance of climate change and ESG to the pensions industry and regulator. He reflected on the fast-changing nature of ESG, particularly considering that the government's green finance strategy was only published in 2019, and its importance as a key discussion item at the G7 summit. He highlighted several challenges facing schemes, investment managers and companies reporting data as they navigate disclosure requirements of the upcoming Pensions Act 2021, including uneven levels of understanding, data integrity, action and implementation mechanisms. However, he also recognised that the need to be ambitious in terms of time frames, combined with delays to regulatory initiatives brought about by the pandemic, meant that data and information will not be perfect at the beginning. It is, however, expected to improve quickly. He highlighted the need for immediate focus on raising awareness, guidance and support for those who need to comply with disclosure in the first wave in order to highlight best practice and develop enforcement mechanisms in preparation for following waves.

Gareth Trainer, Head of UL Investment Solutions, Phoenix Group and **Sindhu Krishna, Head of Responsible Investments, Phoenix Group,** thanked the PPI for their work and opportunity to support the climate change report within the series. They reiterated the exponential interest in climate change, global risks it poses, and the role of the private sector in delivering solutions. Their key observations on reflection of the report included:

1) The need to ensure schemes do not lose sight of market dynamics and customers in favour of strategy and investments, with a particular focus on how maturing member understanding can have a significant impact on what happens in the space. Customers should be central to a roadmap which outlines holistic commitment to understanding where we are, where we want to be and how we get there, in all areas of business.
2) The opportunity as an industry to make a difference as climate change gains huge momentum will require a joined up and collaborative approach and should not be seen as an opportunity to gain competitive advantage. To achieve these gains, it will be essential to understand the barriers to climate change solutions, hence why Phoenix Group endorses the findings of the report.
3) Data will be key to meeting requirements, developing strategy and furthering understanding in an efficient and meaningful way. There is currently very limited correlation between data from numerous providers across the value chain. Industry collaboration will be crucial to consolidating knowledge and supporting standardization.

Andrew Parry, Head of Sustainable Investment, Newton Investment Management, thanked speakers for the informative session and reiterated the key discussion themes of collaboration and shared direction of movement towards a common goal. Whilst the financial services industry can support, finance, encourage and motivate the journey, all of civil society will need to work together with integrated targets to achieve our ambitions of securing a future in which people can retire well into a healthy and vibrant world.

Maria Nazarova-Doyle, Head of Pension Investments, Scottish Widows emphasized the importance of incorporating climate change considerations into investment goals. She also supported the notion that whilst we are in early stages of developing initiatives and solutions to meet ambitious targets, barriers may stop us from doing things perfectly but should not be a barrier to getting started. In the context of data, even if it is incomplete it can all still be used. She cited evidence which shows that low carbon initiatives can improve investment performance as well as corporate financial performance.

Dr. Yvonne Braun, Director of Policy, Long-Term Savings and Protection, Association of British Insurers, reiterated the need for upskilling across the industry, the responsibility to inform savers and mature their understanding of climate change, the emphasis on industry collaboration over industry competition, and the expectation that reporting data will improve as requirements affect more parts of the economy.

Panel discussion and Q&A

The following points were raised in the discussion, chaired by Chris Curry with a panel consisting of Lauren Wilkinson, Michael Eakins, David Fairs, Gareth Trainor, Sindhu Krishna, Andrew Parry, Maria Nazarova-Doyle and Yvonne Braun. This session was held under the

Chatham House Rule and the views expressed do not necessarily reflect the views of the Pensions Policy Institute or panellists.

The following themes of discussion emerged during the panel discussion and Q&A with the audience:

Data Integrity and Metrics

- Even for organisations who want to implement ESG initiatives, there are significant challenges around the validity, quality and accuracy of data, how to aggregate it across different platforms, who to trust, and how to select providers.
- Climate change related disclosures impose demands on trustees, but these can be cascaded through organisations. Building skillsets to interpret data and the internal capabilities to manage it will be key to effective compliance and developing solutions to support climate change initiatives. For smaller schemes, trustees need leadership from government and signposting towards entry level data. It will also be important to ensure that those who outsource their data are able to understand it.
- Costs associated with developing capabilities could be mitigated by standardizing data across the industry, and between entities. The starting point for this would be for the industry to agree on what types of data are needed and why, in order that it can be streamlined through investment chain and inform trustee or members information. Much of the data requirements will come from company financial disclosures, but upcoming global IFRS standards are also expected to be influential.
- Despite the difficulties associated with launching and advancing data capabilities, it was widely agreed that imperfect data at the outset was a price worth paying for timeliness and would improve over time. To improve, metrics must also be meaningful and clear. Methodology should not be prioritized over purpose, and meeting metric targets should not overshadow the need to achieve wider objectives of ESG. Organisations who seek to optimize scores and fail to integrate sustainability into their business models risk compromising the resilience, relevance and returns that ESG strategies are expected to yield.

ESG in Developing Countries

- The importance of understanding ESG in context is highlighted by challenges facing developing countries seeking to transition to sustainable economies. There are concerns that these nations may be priced out of solutions, yet their role in global value and supply chains, and significant contributions to CO_2 emissions will have a significant impact on investment decisions. Although emerging economies represent only 15% of global equities, the knock-on implications of sustainability for other countries will become increasingly important.
- Renewables are, however, becoming increasingly cost effective and their benefits extend beyond operating efficiency to improving health and quality of life in increasingly congested urban environments. In doing so, they are further able to mitigate the proportion of GDP lost to poor health brought about by smog. The financial services industry can support this transition by helping the developing world to do their part, in a way that does not destroy livelihoods and societies through divestments.

Knowledge and Information

- Currently, there is an asymmetry in knowledge regarding climate change initiatives among participants in the investment chain. Strategies will likely need to be developed at trustee level, but at present, investment managers typically have the most experience in managing ESG decisions.
- Considering that the pensions industry is acting on behalf of members when developing ESG strategies, it will also be important to engage with them on the subject in a clear, meaningful, and standardized way. However, members do not typically have a clear understanding of ESG, and communications should focus less on policy and more how decisions impact practical realities.
- There are currently significant gaps between linking ESG data to investment cases and outcomes, including the decisions not to invest in particular assets or sectors. Even if members do not believe in the principles of ESG, investment returns are at the heart of the industry and studies strongly suggest that ESG schemes yield greater returns. The link between ESG decisions and tangible outcomes should be made clear to members through ongoing engagement.

Customer Alignment

- There is a need to address the common communication and engagement divide which exists between pension and investment customers on one hand, and what is done with their money and its impact on the climate on the other. Low rates of engagement with even personally addressed communications suggests that the industry needs to find a different way to talk to people about ESG, moving away from its traditional focus on compliance and disclosure.
- There is a clear need to turn complex topics into things that people can relate to both in their daily lives, and to investment decisions. Many care about the environment but have not yet realized the extent to which their investments could influence the future. ESG could present a valuable opportunity to improve overall levels of engagement with customers since the environment is of such great public importance.
- A further gap was identified whereby despite low engagement, investors implicitly expect managers to be investing responsibly and trust the organisation to be doing the right thing by investing in a way that supports a better society and a greener world. There is a risk that this could lead to significant and rapid reputational challenges going forwards in the event that actions of the industry or managers are not found to be in line with member expectations, accelerated by the high-profile nature of the issue.

Industry Collaboration

- Whilst the traditional focus of ESG has been upon governance, the environment is simultaneously becoming one of the biggest emerging investment risks and opportunities of our time. The pandemic has also brought about changes which are likely to increase the importance of social factors in investments and decision making.
- Collaboration between government, regulators and industry will be central to developing common standards and shared goals. It can also enable lagging institutions to mature and presents a golden opportunity to improve societies of the future for our children and grandchildren.

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We would like to thank our major sponsors of the Engaging with ESG series:

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