DC briefing, April 2021
ESG – What's all the fuss about?

Environmental, Social and Governance (ESG) is hardly a new concept. Since October 2019, trustees of occupational DC schemes, or those with DC AVC sections, have faced new regulatory ESG requirements. However, it's only in recent months that the subject has sprung to life, with the larger pension providers putting ESG at the forefront of their investment proposition.

This briefing looks at the reasons behind this, and explains why ESG will continue to have a material impact on all pension arrangements.

1. Background

Changes in guidance from The Pension Regulator (TPR) guidance in its Code of Practice 13 (the DC Code) required trustees to state their ESG position in their Statement of Investment Principles (SIP) in October 2019 and again in October 2020.

In 2019, trustees had to provide evidence that their policies, relating to financially material considerations such as ESG, were factored into the selection, retention, and realisation of investments. Trustees were also required to consider the exercising of voting rights attached to those investments.

In October 2020, trustee responsibility for ESG increased, with a requirement to capture "the extent (if at all) to which members' views on non-financial matters (including ethical views, views in relation to social and environmental impact and present and future quality of life of the members and beneficiaries of the trust scheme) are taken into account in the selection, retention and realisation of investments".

The Code also requires trustees to add further details of their stewardship policies to their SIP, and to produce an Implementation Statement. The Statement must outline how trustees have implemented the activities and policies which they set out in their SIP the previous year.

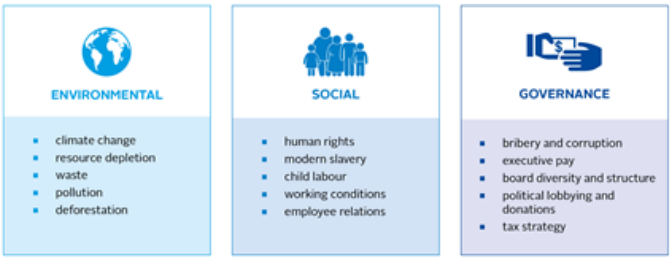
The direction of travel seems clear. We expect pressure to grow from the TPR and also from DC members concerned about how their contributions are invested.

2. The bigger picture

Significant changes are taking place across sovereign states and multinational corporations which up until now have seemed indifferent to areas such as climate change. This is moving ESG from being a 'nice to have' to a corporate imperative. ESG may now reshape financial markets, with profit and growth considered against the constraints of ESG.

3. What is ESG?

The UN PRI (Principles of Responsible Investment) describes ESG as "a series of factors that when applied will guide the explicit and systematic inclusion of ESG issues in investment analysis and investment decisions".



Source: UN PRI 2020

Applying ESG principles will require trustees, or their advisers, to engage with investment managers to influence and achieve change. If such engagement does not deliver meaningful change it may be appropriate to divest.

The overriding objective remains to deliver growth to scheme members. But the focus is now shifting to achieving this within an ESG framework.

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4. How engaged are members about ESG?

DC members in particular are starting to question where their pension funds are invested, according to a recent survey from the Association of Consulting Actuaries (December 2020). However, the survey also showed that this interest in ESG from members has not been matched by significant DC scheme policy shifts. For example, only 12% of DC schemes have a default fund that takes account of climate risk, and 92% of members invest around 80% of their savings in the default fund.

DC schemes are lagging behind DB in their approach to issues such as asset allocation. While over half of the DB schemes are responding and making changes, a significant percentage still remain the same even after review.

5. What are pension providers and investment managers doing?

DC providers are certainly responding to increasing demand from scheme members to provide more information and greater transparency.

Significant change has taken place over the last 6-12 months, with many of the larger providers integrating ESG into both their investment offerings and websites.

Pension schemes have an opportunity to drive change due to the sheer scale of assets they invest globally. The challenge for trustees and providers is to use their power wisely and in a balanced and considered manner.

In December 2020, a number of asset managers signed up to the Net Zero Asset Managers initiative, which will commit them to decarbonising their investment portfolios and accelerating their contribution to achieving net zero greenhouse gas emissions.

6. Winners and losers

As part of its annual review of pension providers and investment managers, First Actuarial's investment team rates and reviews their ESG stance and commitment.

LGIM, Aviva and Aegon are among those currently leading the way on ESG commitment. However, several others, including Standard Life and Scottish Widows, have made recent changes. Others are expected to follow in the coming months. As members pay more attention to ESG-related issues, this will become an area where all providers and managers need to demonstrate their credentials.

We would be happy to share our findings in more detail with you as part of a wider review of your DC pension or AVC arrangement.

6. Your action plan

ESG is becoming unavoidable in the pensions world. Given the confusing terminology and underlying elements of ESG, getting to grips with the sheer breadth of the subject can be challenging.

Our approach to Implementation Statements for hybrid DB/DC schemes is very different from other consultancies. We can work with you to make it as simple as possible.

ESG also provides a great opportunity to engage and communicate proactively with all members, including those particularly concerned about issues such as climate change.

We believe that time spent on ESG issues right now is well spent. Using our experience and expertise, we can help you embed your ESG approach in scheme planning and strategy.

How First Actuarial can help.

If you would like to discuss how we can support you further, please contact the DC team.



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