ENVIRONMENTAL, SOCIAL AND GOVERNANCE (ESG)

MADE SIMPLE GUIDE
ACKNOWLEDGEMENTS

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As active investors, we believe it is our responsibility to encourage companies to maximise investment returns through good governance, including respect for society and the environment. Kames Capital is a significant investor in the equity and debt of many companies, and we are well-placed to actively promote best-practice in environmental, social and governance (ESG) matters. Our investment managers and ESG research team work together to monitor and engage with the companies in which we invest.

We believe that our commitment to ESG integration brings three principal benefits for our clients:

1. **Deepens our understanding**
   - Our focus on ESG means we better understand the environments in which companies operate. This helps us to quantify risks and opportunities.

2. **Strengthens our conviction**
   - Kames Capital is an active investment manager with a fundamental, research-driven approach. Our ESG analysis supports the management of concentrated, high-conviction portfolios that can meet the performance aspirations of our clients.

3. **Promotes a long-term focus**
   - Evidence shows that companies which rank among the leaders in governance and sustainability are more likely to outperform as investments over the long term. Integrating ESG factors into our research helps us to avoid short-term distractions and stay focused on the long-term prospects for companies and sectors.

As a subsidiary of Aegon NV and part of Aegon Asset Management, Kames Capital contributes to, and participates in the group’s broader responsible investment activities. We are an active member of the UK Investment Association’s Sustainability and Responsible Investment Committee, and therefore closely involved in formulating best practice for responsible investment globally and locally.

In addition, Kames Capital is a member of, or supports a range of other responsible-investment initiatives, including the UN-backed Principles for Responsible Investment, the UK Sustainable Investment and Finance Association, the Extractives Industry Transparency Initiative, Carbon Disclosure Project, Climate Action 100+ and the Farm Animal Investment Risk and Return initiative. Our participation in these initiatives helps us to deepen our knowledge and maximise our influence on ESG issues for the benefit of clients, the environment and society.

Stephen Jones
Chief Investment Officer, Kames Capital
ESG HAS BECOME A FAMILIAR ABBREVIATION TO MOST PEOPLE INSIDE – AND INCREASINGLY OUTSIDE – THE INVESTMENT WORLD. BUT WHAT EXACTLY DEFINES IT?

As the consideration of ESG factors has become mainstream in the pension and investment world, UK policymakers have decided to more formally enshrine ESG into investment mandates through clarifying trustee duties around the consideration of financially material ESG factors (including climate change). The concept and aims of ESG investing have varied over time, while fluid terminology and subtle variations have created some confusion. The result is that many trustees have been unsure of how ESG investment interacts with their fiduciary duties.

Though investment practitioners and academics broadly agree on the merits of ESG, there is still a debate over what ESG and related ‘responsible investment’ (or ‘sustainable investment’) really means, and how it should be integrated into investment decisions and strategies.

In this guide, we aim to explain ESG as an investment concept and suggest how it can be integrated into the investment strategy and oversight of pension schemes. We also examine means of integration, provide a glossary of relevant terms, highlight some key organisations and frameworks in the ESG space, focus on key trends and themes, and suggest a template for pension schemes to help them create their own ESG policy.

Investment regulations on the consideration of ESG factors are changing, both in the UK and internationally, so these issues cannot be ignored. The pressure is on pension schemes to think about how they consider ESG risks and opportunities in their investment decisions.

Trustees have perhaps considered their principal duty as being to provide the best possible financial outcome for members – in other words, the maximisation of investment returns. The actual wording from the Law Commission’s 2014 report on the Fiduciary Duties of Investment Intermediaries specifies acting in the best “financial interests” of members. However, this should not, according to the Law Commission, be interpreted as simply pursuing the best possible investment returns. While a positive return can be rightly expected by scheme members over time, risks have to be considered. These should not be limited to traditional financial risks, but should also include other risks if these could impact the returns of the fund or the interests of its members - i.e. if they are financially material.

To this end, recent rules drawn up by the Department for Work and Pensions (DWP) require pension schemes to clarify and explain their policies regarding how they have considered financially material ESG (including climate change) factors and stewardship. These rules are an update of the Occupational Pension Schemes (Investment) Regulations 2005 and are formally titled the ‘Pension Protection Fund (Pensionable Service) and Occupational Pension Schemes (Investment and Disclosure) (Amendment and Modification) Regulations 2018’. They seek to clearly set out the fiduciary responsibilities of trustees.

Trustees of defined contribution (DC) schemes will also be required to publish their Statement of Investment Principles (SIP) on a publicly available website, and to produce and publish an implementation report setting out how they acted on the principles set out in the SIP.

The DWP states that “financially material considerations include (but are not limited to) environmental, social and governance considerations (including but not limited to climate change)”. Furthermore, trustees have the option of including a policy on “non-financial matters”, including not only members’ ethical concerns but also social and environmental impact matters and quality of life considerations. Effectively, these regulations require trustees to take greater and more active ownership, and to consider ESG factors more comprehensively.

Trustees should also consider the implications of the 2019 changes to the Investment Regulations, which implement the EU’s second Shareholder Rights Directive (SRD II). These regulations will require further detail on trustee stewardship policies to be added to defined benefit (DB) and DC pension scheme SIPs. Additionally, DB schemes will also be required to produce a form of implementation statement on their engagement and voting practices.

All these regulatory initiatives mean it is more important than ever that trustees have a clear strategy on ESG. Through the remainder of this guide, we aim to make ESG simple for trustees.
ESG TERMINOLOGY

ESG IS A DISTILLATION OF SEPARATE BUT LINKED CONCEPTS THAT UNDERPIN SO-CALLED RESPONSIBLE (OR SUSTAINABLE) INVESTING. ‘ENVIRONMENTAL’, ‘SOCIAL’ AND ‘GOVERNANCE’ EACH COVER A RANGE OF FACTORS THAT, WHEN CONSIDERED TOGETHER, BUILD A PICTURE OF AN ENTERPRISE’S CREDENTIALS REGARDING SUSTAINABILITY, EQUALITY AND CORPORATE FAIRNESS.

KEY ESG FACTORS INCLUDE:

ENVIRONMENTAL
Energy use, waste disposal, raw material sourcing, carbon emissions, water usage, recycling process.

SOCIAL
Diversity, treatment of minorities, opportunities for women, employee rights, charitable activities, community work, use of agency workers.

GOVERNANCE
Composition of boards, external trustees, available share classes, interaction with shareholders, remuneration, voters’ rights.

The consideration of ESG factors in investment decision-making has been growing in popularity for several decades, with many UK pension schemes leading the way in doing so. However, we recognise that these terms can still be confusing and are often used loosely, creating an unintended or unclear message. In this section, we provide a glossary to clearly define their meanings.
ESG
Environmental, social and governance factors that may affect the performance of a company or asset.

RESPONSIBLE INVESTMENT STRATEGIES
This relates to products and funds that use ESG factors as a basis for specific investment strategies.

NEGATIVE SCREENING
Excluding securities based on specific activities or industries.

POSITIVE SCREENING
Overweighting of issuers with better or improving ESG performance relative to sector peers.

BEST-IN-CLASS INVESTMENT
An investment style that involves investing only in companies that lead their peer groups in respect of sustainability performance. Some managers argue that portfolios should balance ESG leaders with improvers.

ACTIVE OWNERSHIP
Entering into a dialogue with companies or countries on ESG issues and exercising both ownership rights and voice.

ESG INTEGRATION
Systematic inclusion of ESG risks and opportunities in investment analysis, portfolio construction and risk management.

THEMATIC INVESTING
Investment themes based on ESG issues, such as clean technology, energy efficiency or water.

IMPACT INVESTING
Investing with the intention to generate and measure social and environmental benefits alongside a financial return.

SUSTAINABLE AND DEVELOPMENT GOALS (SDGs)
Investing with the goal of contributing towards one or more of the United Nations SDGs – see Section 8 for further details.

GREENWASHING
This refers to the controversial promotion or ‘spinning’ of a company’s or manager’s ‘green’ or ‘sustainable’ credentials, when the reality can be markedly different.

SOCIALLY RESPONSIBLE INVESTMENT
Often referred to as ‘SRI’, this is a general term which is common in the UK. It is an amalgamation of four of the approaches above – negative screening, positive screening, active ownership and ESG integration. It combines seeking investment returns with ethical investing (investing in line with a set of moral or ethical principles).
3 MANAGER SELECTION

HOW SHOULD TRUSTEES INCORPORATE ESG INTO THEIR SELECTION OF MANAGERS? THE PRINCIPLES FOR RESPONSIBLE INVESTMENT (PRI) GUIDELINES SUGGEST THAT “AN ASSET OWNER SHOULD ENSURE THAT A COHERENT SET OF EXPECTATIONS IS COMMUNICATED TO AGENTS ACTING ON THEIR OWN BEHALF, AND CAN ALIGN INCENTIVE STRUCTURES WITH THESE EXPECTATIONS”.

The 2018 Department for Work and Pensions (DWP) guidelines go further, obligating schemes to disclose how they have considered “financially material” ESG factors. Qualifying schemes will need to produce, update and publish their Statement of Investment Principles (SIP), complete with a statement on ESG and an expanded statement on stewardship. Further information can be found in the PLSA’s ‘ESG and Stewardship: A practical guide to trustee duties’, published in June 2019.

What does this mean in practice? The responsibility sits with the trustees to work with their advisers to set the standards and agree relevant metrics for measuring their (third-party) asset managers’ credentials. When hiring a manager, the trustees must make the manager aware of the scheme’s standards and expectations, so that there is no future conflict. There should be alignment between the strategies, principles and objectives of both the scheme and the asset manager.

Potential conflict and misunderstanding should be avoided at the earliest stage of selection by using a well-crafted and comprehensive questionnaire that covers ESG factors. The trustees, normally with support from their consultant advisers, can then delve into the common features of each ESG strategy and examine how deeply embedded and understood ESG factors are – or are not – at the prospective asset manager.

For most schemes, consultants play a key role in the consideration and hiring of asset managers. Many consultants will rate asset managers on their ESG credentials, including the integration of ESG factors into investment processes and commitment to active ownership; for example, by reviewing company engagements or proxy-voting patterns. Such ratings are a starting point, and should not be an excuse for not thoroughly investigating and ‘getting under the skin of’ a potential asset manager’s ESG credentials and approach.

While many consultants are committed to helping schemes create and develop an effective approach to ESG, schemes cannot delegate responsibility and should ensure they communicate to advisers, and other service providers, their specific requirements and aims. The new regulations and widespread adoption by schemes are encouraging more consultants to offer comprehensive ESG services which include analysing, rating and recommending managers based on their ESG credentials.

These ratings, based on analysis of both qualitative and quantitative data, are one of the most visible indicators of each manager’s ESG credentials. We undertake a fuller discussion of third-party ESG ratings in Section 6.

What is critical, and what legislation is encouraging, is the consideration of ESG factors at the trustee board level, so that the board’s strategy on ESG is reflected through their investments.

Further practical step-by-step guidance is provided in chapter 7.
MOST ASSET MANAGERS NOW HAVE RELATIVELY SOPHISTICATED PROCESSES THAT INTEGRATE ESG FACTORS INTO THEIR INVESTMENT APPROACHES.

The PRI’s guidelines define ESG integration as “the explicit and systematic inclusion of ESG factors in investment analysis and investment decisions”. It is a holistic approach to investment analysis, where material factors – ESG and traditional financial factors – are identified and assessed in order to form an investment decision.

To achieve comprehensive integration, investment managers and specialist ESG research teams should work together to monitor and engage with the companies in which they invest. This activity covers all asset classes, including fixed income, equities, property, alternatives and multi-asset funds. Below, we consider the major asset categories and ways of integrating ESG factors into the analytical process:

PUBLIC EQUITIES

There is a growing belief that integrating a company’s ESG performance within fundamental analysis is a tool for both value creation and risk management. Simply put, there is more evidence that companies with sustainable business models can deliver superior long-term financial returns.

Analysts should seek to identify and understand the key ESG risks for each of the companies, industries and sectors in which they invest. A company’s ESG performance can be considered within the context of its industry’s competitive landscape, in relation to its peers and the geographic regions in which it operates. An understanding of the ESG issues that a company faces requires in-depth knowledge of the sector in which it operates.

FIXED INCOME

As with equities, fixed income analysts should be aware of an issuer’s ESG credentials. Rather than an industry or geographical split, as favoured in equities, analytical responsibilities in fixed income can be apportioned efficiently by bond market segment: government markets, investment grade non-financials, financials and high yield bonds. Analysts would be responsible for ensuring effective integration of ESG inputs with analysis and valuation discussions.

PROPERTY

The integration of ESG factors in property should necessarily be a little different. All ESG factors are still considered when assessing new properties and managing existing assets. For new acquisitions, the due diligence process should assess the validity and attractiveness of a property in offering a secure investment return for shareholders. A Sustainability Risk Assessment considers the environmental performance of the property, the alignment of interests with tenants and the regulatory landscape.

Current property portfolios can be assessed through a structured gap analysis against best practice. The opportunities are then rated and ranked based on their effective contribution to sustainability objectives and vision.

ALTERNATIVES

Alternative investments, such as infrastructure and renewable energy assets, can also be viewed through the ESG prism. These are typically long-life assets which makes them attractive to pension funds. Management and operating practices, as well as the environmental impact of, for instance, large-scale engineering projects can and should be assessed during initial analysis. This should be relatively straightforward to incorporate.

MULTI-ASSET

Multi-asset funds are essentially a blend of a range of asset classes that seek to meet the investment objectives and risk profiles of clients. ESG factors would often already be considered by bond, equity, property or alternative analysts. Multi-asset managers might also want to incorporate an overarching ESG policy or ‘tolerance’ parameters over assets in the fund. This may restrict the weighting of certain assets.

Much of the above is about the comprehensive assessment of risk of each security or asset, from which a more reasonable assessment of future return can be made. The consideration of ESG factors is the gateway to more active ownership – engaging more openly with company management and voting at AGMs – which can only lead to better outcomes for all parties.
5

ESG AND DC PENSIONS

HISTORICALLY, IT HAS BEEN DIFFICULT FOR DEFINED-CONTRIBUTION PENSION FUNDS TO CLEARLY INTERPRET THE ESG LANDSCAPE AND TURN IT INTO PRINCIPLES AND CONCRETE ACTION FOR THEIR FUNDS. WHILE THE WILL HAS ARGUABLY BEEN THERE, THERE HAS BEEN A NEED FOR GREATER CLARITY FROM POLICYMAKERS.

The PLSA and Sustainalytics 2017 paper ESG Risk in ‘Default Funds: Analysis of the UK’s DC Pension Market’ found that DC plan members investing in their scheme’s default fund are significantly exposed to a number of ESG risks, including those related to human capital, business ethics, product safety, and data privacy and security.

The Defined Contribution Investment Forum (DCIF) April 2018 paper ‘Navigating ESG: A practical guide’ acknowledges the challenges faced by DC pension schemes in their efforts to reflect ESG principles in their funds. It challenges trustee obligations, saver engagement in investment and definitions of responsible.

The law has hitherto been ambiguous, seemingly content to leave it to schemes’ discretion as to whether to incorporate ESG factors. This has often led to a conservative interpretation of schemes’ responsibilities and encouraged a wait-and-see approach.

DC SCHEMES’ LONG-TERM INVESTMENT HORIZONS

What is increasingly acknowledged is that ESG risks are material and it is, therefore, the fiduciary duty of trustees to consider these risks alongside others, such as longevity or liquidity. The grey area has largely been in the notion of non-financial matters, under which ESG risks have been deemed to sit. The reality is that many ESG factors can affect the financials of corporations and be financially material.

While schemes should not impose moral or ethical views, they can and should reflect the views of their members if there is a majority view that ESG issues are of concern. Nor should schemes take a passive view of non-financial risks. There is also a sense that, given the nature of the assets in DC schemes and the long-term risks they face, ESG factors should be properly considered, given that they are long term by nature, embracing issues such as climate change, company governance and the longstanding suppression of minorities and women.

THE ROLE OF MEMBER VIEWS

Part of the issue for DC schemes is explaining or clearly defining what ESG risk is, because there is no standard definition. Also, regarding ESG, where exactly does the accountability sit? While members may be concerned about ESG matters, they have not always seen the necessity of their scheme to engage more fully with asset managers about these issues. There is some evidence of generational differences, with younger investors seemingly more engaged with these issues relative to older members.

It is partly an issue of education, and realisation by scheme members that their viewpoints on ESG matters can be incorporated into the scheme’s stated policy can, in turn, have an impact on the asset managers and the practices of the underlying companies.

This may call for greater engagement from schemes with both their members and asset managers, as members become aware that ESG principles can be integrated into their schemes’ policies and really make a difference. For some, it can be a surprise that their schemes may not be actively advocating ESG principles.

The good news is that UK pension schemes are, by and large, embracing their responsibilities regarding ESG investing. This partly reflects a membership that believes that ESG matters are important. Indeed, over 80% of members “believe that businesses have a wider social responsibility than simply making a profit”.

Environmental, Social and Governance (ESG)
ESG THEMES

IN THIS SECTION, WE EXPLORE SEVERAL EMERGING ESG THEMES THAT ARE GROWING IN PROMINENCE AMONG PENSION SCHEMES.

CLIMATE CHANGE AND CARBON PRICING

The evidence of the catastrophic effects of climate change are increasingly visible, and there are many experts who believe we only have a comparatively short period of time – 10 or possibly 20 years – to prevent irreversible damage to our world. The pursuit of sustainable working practices and habits is ever more crucial to prevent a tipping-point, from which there may be no return.

The Paris Agreement of 2015 on global climate change committed signatories to keeping the increase in average global temperatures to less than 2.0 degrees Celsius, and preferably less than 1.5 degrees Celsius, compared with pre-industrial levels. From an investor point of view, there is increasing evidence that investment decisions really do make a difference. The consideration of environmental factors is important for two reasons: they can make a difference on climate change and they can benefit the investor. For example, investing in a carbon-light emitting or renewable energy company will most likely be beneficial in the long run for the environment, and potentially for portfolio returns. It is a win-win situation.

The development of carbon pricing is just one of a series of innovative climate-conscious methods of offsetting the impact of carbon emissions. Carbon emitters, such as fossil-fuel energy firms or utility companies, can buy tradeable permits to offset the amount of carbon they emit into the atmosphere. As carbon producers, the incentive is on them to cut emissions or pay for permits (which, in turn, helps drive forward or pay for carbon clear-up). The PLSA and ClientEarth have produced guidance for schemes to help provide a clear and practical framework for trustees considering climate risk in their investments. The Taskforce on Climate-Related Financial Disclosure (TCFD) is also worth consideration by trustees. Further details are given in Section 8.

ESG RATINGS

THERE ARE A RANGE OF INDEPENDENT ESG-RATING AGENCIES IN THE MARKET. EACH HAS ITS OWN SPECIFIC METHOD AND CRITERIA FOR RATING COMPANIES AND INVESTMENT MANAGERS ON THEIR APPROACHES TO ESG, WITH AN OVERALL SCORE PROVIDING CUSTOMERS WITH QUANTITATIVE GUIDANCE REGARDING ESG CREDENTIALS.

While these should form a part of trustee decision-making, schemes should make sure they fully understand the methodologies used as this can vary between agencies.

Key issues that schemes should consider include:

- whether the criteria used are material to the companies assessed;
- whether different measures have been aggregated equally i.e. with no weighting for importance;
- whether the ESG screen they are considering examines the sustainability of a company’s products or services;
- whether it focuses mostly on how a company operates (instead of what it does).
Depending on which approach is chosen, ratings may end up attributing strong sustainability credentials to companies whose products or services could be considered fundamentally unsustainable.

Whether a given rating agency’s criteria favours large-cap companies over smaller ones is another area for consideration. Some smaller companies cannot provide all the data either because they are in the early stages of existence or lack the resources to respond effectively. This can ultimately impact their scoring relative to larger or more mature companies.

It is also important that schemes understand whether or not the ratings being used only take a ‘backward-looking’ approach to a company’s ESG credentials, without saying anything about potential changes to a company’s ESG strategy. There may be companies with management teams that, while not scoring highly at the present time, are making marked efforts to improve their sustainability record – which may also have a powerful impact on their performance.

Quantitative ratings can be a useful starting point for helping schemes to evaluate a company’s ESG credentials. However, any ratings should also be combined with qualitative, bottom-up appraisal of a company to form a real understanding of its business and goals. Bottom-up, rigorous analysis can capture the nuance of material products’ impact and the effect of ESG factors when valuing a company.

It is important for schemes to carefully consider the various data-source providers and select the one that most readily supports and embodies their own philosophy and process. This should then be clearly communicated by the investment manager so that stakeholders are aware of the approach.

### ESG AND GOVERNMENT BONDS

**Assessing ESG Factors Within Government Bond Portfolios Assists the Identification of Sovereign Credits With Lower Long-Term Credit or Default Risk Not Reflected in Current Market Prices. Each ESG Component Has a Different Material Impact on This Risk, Some More Significant Than Others. This is Particularly Relevant Given the Relatively High Allocations to UK Government Bonds by DB Pension Schemes.**

Governance is the principal factor in indicating sovereign credit risk, particularly at the lower end of the ratings scale. Many past sovereign defaults have been directly related to institutional and political weakness, such as political instability, unwillingness to pay debt, corruption, inadequate governance or weak budget management.

Social factors are less significant, but can be highly correlated to GDP and wealth conditions, which are drivers of sovereign risk. Education, equality, health, life expectancy and poverty can all impact social cohesion and productivity, which contribute to competitiveness and potential for growth.

Environmental variables are least correlated with risk, although countries that are prone to weather-related issues are more affected by climate change. It is also possible that governments that seek to make positive changes in environmental matters can detrimentally effect returns.

Although the vast majority of developed markets are stable with robust infrastructures, the above ESG factors remain a fundamental component of effective research analysis.
# Creating Your Pension Scheme’s ESG Policy

The pressure is now on scheme boards and trustees to implement their own ESG strategy, if they have not already done so, and to communicate this to stakeholders. Below, we provide a suggested checklist of the steps that a scheme could take to become fully ESG compliant. Further details can be found in the PLSA’s ‘ESG and Stewardship: A Practical Guide to Trustee Duties’ (June 2019).

## ESG Checklist

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<tr>
<th>Step</th>
<th>Description</th>
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<tr>
<td>1. EDUCATE</td>
<td>Ensure that board members and trustees have received training and education in ESG matters, covering areas such as defining financial materiality, governance and climate change.</td>
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<tr>
<td>2. DISCUSS</td>
<td>Discuss the relevant and appropriate ESG factors to reflect in your scheme at board and trustee level. Define and agree the trustee board’s investment beliefs and ensure they reflect your view of the risks and opportunities relating to ESG. Discuss ESG governance structure. Ensure that advice is sought where necessary and appropriate.</td>
</tr>
<tr>
<td>3. DEFINE</td>
<td>Once the board and trustees have decided on a scheme’s ESG strategy, it should incorporate it in a clear Statement of Investment Principles. This should set out how the trustees will invest the assets of the scheme, and outline the principles and policies governing investment decisions made by or on behalf of the scheme.</td>
</tr>
<tr>
<td>4. COMMUNICATE</td>
<td>Communicate the strategy to the scheme’s consultants, managers, members and sponsoring employer.</td>
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<tr>
<td>5. EVALUATE</td>
<td>With help from the consultants, assess existing asset managers on the stated ESG strategy, either as part of regular reporting or as a standalone project.</td>
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<tr>
<td>6. REVIEW</td>
<td>Assess the scheme’s ESG policy, and manager’s compliance with it, at future trustee meetings.</td>
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<tr>
<td>7. REPORT</td>
<td>In addition to publishing their Statement of Investment Principles online, trustees of DC schemes will be required by law to publish a report detailing the implementation against the SIP by 2020. Trustees should also consider whether they want to report (in part or fully) in line with the Task Force on Climate-related Financial Disclosures (TCFD) recommendations.</td>
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THE PLSA PROVIDES A RANGE OF OTHER PRACTICAL HELP TO SCHEMES TO SUPPORT THEM IN BECOMING BETTER STEWARDS OF THEIR ASSETS. IN THIS SECTION, WE LOOK AT SOME OF THE OTHER LEADING UK AND INTERNATIONAL ORGANISATIONS IN THE ESG SPACE. PARTICIPATION IN THESE INITIATIVES CAN HELP PENSION SCHEMES AND INVESTMENT MANAGERS DEEPEN THEIR KNOWLEDGE AND MAXIMISE THEIR INFLUENCE ON ESG ISSUES. THIS LIST IS NOT INTENDED TO BE EXHAUSTIVE.

Pension schemes should ask their managers and advisers which of these organisations they are a part of, or contribute to, and the extent of their involvement. Such information can be a useful factor for schemes to consider when trying to gauge which managers are doing substantive work on ESG and stewardship issues.

Climate Action 100+ is a five-year initiative led by investors to engage with the world’s largest corporate greenhouse-gas emitters to improve governance on climate change, curb emissions and strengthen climate-related financial disclosures. Over 250 investors are signatories to the initiative. The initiative is designed to implement the investor commitment first set out in the Global Investor Statement on Climate Change in the months leading up to the adoption of the historic Paris Agreement in 2015.

CDP (formerly Carbon Disclosure Project). CDP is a not-for-profit organisation that runs the global disclosure system for investors, companies, cities, states and regions to manage their environmental impacts. Over the past 15 years, CDP has created a system that has resulted in unparalleled engagement in environmental issues worldwide.

Established in 2015 by the Jeremy Coller Foundation, the Farm Animal Investment Risk & Return (FAIRR) initiative is an investor network that aims to put factory farming on the ESG agenda.

Issues associated with factory farming can present a range of risks to investors. Above the surface, scandals such as swine flu, avian flu and horsemeat have shown how industrial production methods can lead to value destruction. FAIRR is working with its network to highlight other related risks associated with this method of livestock production. FAIRR acts as a global collaborative network that shares research, fresh thinking and best practice with global institutional investors, policymakers, academics, NGOs and other related actors.
Extractive Industries Transparency Initiative (EITI). EITI works for increased transparency and strong governance in the global oil, gas and minerals sector.

The Financial Reporting Council (FRC) promotes high standards of corporate governance in the UK. Asset owners and asset managers can become signatories to its Stewardship Code, and each year must publish an annual statement to explain compliance.

In March 2019, the FRC published its draft Plan and Budget for 2019-20, which proposed changes to the FRC’s governance and powers as it transitions to a new statutory regulator, the Audit Reporting and Governance Authority.

A consultation on the future of the Stewardship Code proposed an expanded definition:

“Stewardship is the responsible allocation and management of capital across the institutional investment community to create sustainable value for beneficiaries, the economy and society. Stewardship activities include monitoring assets and service providers, engaging issuers and holding them to account on material issues, and publicly reporting on the outcomes of these activities.”

This definition identifies the primary purpose of stewardship as looking after the assets of beneficiaries that have been entrusted to the care of others. It also broadens the scope of the Code to be applicable beyond UK-Listed equity assets.

The requirements of the new code is to have:

1. A Policy and Practice statement.
2. An annual activities and outcomes report.

At the time of writing, the consultation is open.

The Global Real Estate Sustainability Benchmark (GRESB) evaluates the ESG credentials of real estate and infrastructure funds.

GRESB is an industry-driven organisation committed to assessing the sustainability performance of real assets around the globe, including real estate portfolios (public, private and direct). On behalf of close to 75 institutional investors, GRESB has assessed over 900 property companies and funds globally.
The University of Cambridge Institute for Sustainability Leadership (CISL) seeks to offer ideas and solutions for a sustainable economy.

The CISL seeks to quantify ESG factors through the accumulation of concrete evidence and data, rather than subjective views or opinions, measuring the impact on the environment and society of companies’ actions. The goal of this is to provide deeper, more objective intelligence that will provide investors and users of financial services with a framework to compare the impact of company activity and make decisions accordingly.

The Investment Leaders Group (ILG) is a voluntary initiative, driven by its members, facilitated by the CISL, and supported by academics in the University of Cambridge and elsewhere.

The ILG is comprised of 12 leading investment managers and asset owners with over US $12 trillion under management. Roelie van Wijk-Russchen, Aegon Asset Management’s Global Head of Responsible Business and Public Affairs, chairs the ILG.

The ILG believes that responsibility should be at the heart of the investment process in order to best serve clients and beneficiaries.

The FSB Task Force on Climate-related Financial Disclosures (TCFD) will develop voluntary, consistent climate-related financial risk disclosures for use by companies in providing information to investors, lenders, insurers and other stakeholders.

The Task Force will consider the physical, liability and transition risks associated with climate change and what constitutes effective financial disclosures across industries.

The work and recommendations of the Task Force will help companies understand what financial markets want from disclosure in order to measure and respond to climate change risks, and encourage firms to align their disclosures with investors’ needs.

For more information visit [www.fsb-tcfd.org](http://www.fsb-tcfd.org).
The Principles for Responsible Investment (PRI) was launched in April 2006 by the United Nations. Its aim has been to incorporate its principles regarding sustainability into the philosophy and processes of asset owners and managers. There are six defined ‘Principles’ that signatories agree to:

1. Incorporate ESG issues into investment analysis and decision-making processes.
2. Be active owners and incorporate ESG issues into ownership policies and practices.
3. Seek appropriate disclosure on ESG issues by the entities in which they invest.
4. Promote acceptance and implementation of the Principles within the investment industry.
5. Work together to enhance effectiveness in implementing the Principles.

For more information visit [www.unpri.org](http://www.unpri.org)

Linked to the PRI are the UN Sustainable Development Goals, which define 17 targets or goals set by the UN for delivery by 2030. They include a mix of ESG issues such as education, gender equality, climate action, the eradication of hunger and poverty. The goals are broad but do have related and measurable indicators. How signatories interpret the best means of achieving these goals is left to them. The goals are intentionally ambitious, and if reflected in investment processes may require some measure of ‘impact investing’, meaning investments are made with the aim of furthering some, or all, of these goals.
CONCLUSION

RECENT REGULATORY CHANGES HAVE PROVIDED THE IMPETUS FOR ESG TO BE MORE FULLY EMBEDDED ACROSS ALL INVESTMENT PRACTITIONERS. WHILE 2018 CHANGES TO THE INVESTMENT REGULATIONS FROM THE DWP WILL DIRECTLY DEAL WITH PENSION SCHEMES AND THEIR APPROACH TO ESG, THE KNOCK-ON EFFECT FROM THIS AND OTHER RELATED REGULATIONS AND GUIDANCE WILL BE FELT BY OTHER STAKEHOLDERS, SUCH AS CONSULTANTS AND ASSET MANAGERS.

ESG, if it wasn’t already, is mainstream. Proper and full integration of ESG factors has become a necessity for schemes. It is one that should be embraced as it can lead to better, more comprehensive risk assessment, better long-term returns and better outcomes for the world at large.
This guide is for information only and is not advice about investment and must not be relied upon to make any financial decisions.