Briefing

ESG in focus

The Department for Work and Pensions issued a consultation on clarifying and strengthening trustees' investment duties in June 2018, with responses requested by mid-July. The focus of the consultation is on the expectations upon trustees to take account of financially material risks within their investment strategies.

Whilst factors such as interest rates, equity risk, longevity etc. are widely considered, the consultation explicitly references those risks associated with Environmental, Social and Governance (ESG) factors.

The consultation proposals

The key proposals which will impact trustees of both DB and DC pension schemes are that:

- the Statement of Investment Principles (from October 2019) should state the trustees' policy in relation to:
    - financially material considerations, including (but not limited to) those arising from ESG considerations, including climate change
    - stewardship of the investments, including engagement with investee firms and exercise of voting rights
- the default (DC) strategy should reflect how the trustees take account of financially material considerations, including ESG matters, and the SIP should be published on a member website (for DC schemes)
- the Trustees can take account of any opinions they have on members' views in relation to matters set out in the SIP and have to publish a statement of the views and how they have taken these into account
- subsequently the trustees should prepare an implementation report setting out how they acted on the principles set out in the SIP and how they acted on the statement which covered how they would take account of members' views

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beyond the expected

Our view

Overall the consultation, if enacted, will be a positive for schemes, as it will help to remove some of the uncertainty about what is expected of trustees as long term investors. In particular, it helps to place the emphasis of the ESG policy on risk management rather than ethical considerations.

> This, we think, aids trustees in considering a range of options proportionate to their scheme (i.e. not ripping up their strategy and starting again), but nonetheless having to demonstrate a greater level of engagement than previously.

It does, though, spell the end of a one-line comment in the SIP (to satisfy the 2005 investment regulations) about "the extent (if at all) to which social, environmental or ethical considerations are taken into account in the selection, retention and realisation of investments" and "their policy (if any) in relation to the exercise of the rights (including voting rights) attaching to the investment". Our expectation is that relying on the "if any" clause will become insufficient.

What might trustees do to prepare?

The direction of travel in which the consultation is heading will, we expect, require the majority of trustees to actively consider, potentially in detail for the first time, their approach to ESG factors within their investment strategy. The consultation cites evidence from Professional Pensions (less than half of survey respondents took ESG into account when making investment decisions) and Hermes ('People believe it naturally excludes certain areas that have done well in recent years – tobacco stocks, for example. However, this is to misunderstand ESG, which is about understanding the long-term sustainability of a company and having strong governance. It is about being aware of the risks') to support a more engaged approach. As a result, we would suggest trustees consider:

What account does your existing strategy take of ESG matters?

Should ESG pervade your entire strategy, or parts of it?

How could the ESG credentials of managers be assessed as part of manager selection processes, and on an ongoing basis?

How can members' views be assessed and taken into account?

Please contact your Barnett Waddingham consultant if you would like to discuss any of the above topics in more detail. Alternatively get in touch with Neil Davies via the following:

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