A little less conversation, a little more action please

Trustees have no reason to ignore ESG when investing, says Aon's Tim Manuel

STRANGELY ENOUGH, Elvis Presley's views on responsible investment went undocumented. But his 1970 song could have been written as an anthem for pension schemes' current progress on responsible investment.

Who would have thought 'The King' would have been so closely aligned with The Pensions Regulator (TPR), which is now forcing that action from trustees – albeit at quite a basic level?

Responsible investment is no longer a 'should do' for trustees – it is now a 'got to do'. Every defined benefit and defined contribution scheme must now document how ESG factors are being considered in their investment decision-making, and how they will manage them over time.

Beyond regulatory requirements, there are many reasons why schemes should address responsible investment. But, despite the link between ESG and long-term profitability becoming ever clearer, this is not yet translating into widespread action in schemes' investment mandates.

The explanations for that are as varied as schemes themselves, but new research from Aon – *COVID, climate and compliance – are you ready for the new investment challenges?* – identified some key barriers. We spoke to pension decision-makers about investment topics including responsible investment, governance and cost transparency.

Not enough trustee knowledge or governance time – Even schemes that are committed to responsible investment say it takes time. "It's not a single decision to adopt ESG, it's many different decisions and a much longer process than people think," said one of our respondents.

Responsible investment is just part of good governance. The process of establishing beliefs, embedding them in the Statement of Investment Principles, canvassing member views, and moving funds is not an overnight switch, and does not have to be a trigger to change the entire portfolio.

Regardless of a scheme's size or background, if there is commitment to change, there will be a way of achieving it. The approach can made be appropriate to a scheme's circumstances and constraints.

That also applies to ongoing stewardship and due diligence. Trustees need to take ownership and push their existing asset managers and consultants to explain how they are adhering to the scheme's beliefs. New mandates should feature those same beliefs and become part of the decision-making process for selecting a manager.

The market is too confusing – despite efforts towards standardisation, 'ESG' is an overused and often abused fund label, and some respondents in our survey were unsure what it really meant. Asset managers' interpretations range from a superficial 'green' tint with an extra charge applied, through to well-designed, affordable funds with responsible investment principles positioned at their core.

However, we are seeing a lot of innovation from fund managers. One respondent in our research acknowledged this: "The products are improving, particularly passive funds with tilts. I think that's a helpful development because it's a relatively small shift in risk terms but can have quite a decent impact."

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Investment consultants and fiduciary managers can help evaluate the market on trustees' behalf or make fund manager selections according to the scheme's beliefs and circumstances.

A concern that responsible investment conflicts with trustees' fiduciary duty to members – The risks associated with climate change will impact almost every industry sector. Failure to address them will affect members' returns and their wider quality of life. There have been billion-dollar write-offs in the energy sector as the industry downgrades its long-term energy price projections, with climate change being cited as a factor. Companies, especially those in the extractive industries, are facing huge lawsuits where human rights abuses have been alleged in their supply chains.

However, our research still found reservations about the link between responsible investment and fiduciary duty, although there has been progress. A respondent said: "Trustees see the relevance of ESG. They support the principles of it, they want to demonstrate they're compliant with it. But it's not driving investment behaviour, or investment decisions."

We are also seeing moves towards modelling climate risk alongside other types of portfolio risk, such as inflation and interest rates. This should help trustees to quantify the risks of climate change, and the potential effect on their returns over time.

There are no credible reasons for trustees to ignore responsible investment. There is a wealth of opportunities and approaches available to suit all schemes, either delivered by existing managers and consultants, or through models such as fiduciary management. To draw further on Elvis's responsible investment credentials: it's now or never.

Tim Manuel, head of responsible investment, Aon