Putting Responsible Investment into Practice

Aon's Responsible Investment Network Meeting,
21 February 2019 – Key Outcomes

Empower Results®

Aon's Responsible Investment Roadmap

Tim Manuel introduced Aon’s Responsible Investment Roadmap (the 'Roadmap'), designed to support trustees in their approach to adopting Responsible Investment practices.

The Roadmap includes four stages:

1. **Discover:** Focused on raising awareness and defining beliefs around ESG
2. **Develop:** Formulate and agree investment objectives and polices
3. **Deliver:** Assess the risks in portfolios, asset allocation or wider risks, for example as part of the sponsor covenant; and review and select investments
4. **Review:** Ongoing engagement, for example with investment managers or stakeholders, and report progress.

Discover	1	Raise awareness
	2	Define beliefs
Develop	3	Agree objectives
	4	Agree policies
Deliver	5	Assess risks
	6	Review / select investments
Review	7	Ongoing engagement
	8	Reporting and review

The majority of trustees are at the early stage of their Responsible Investment journey and members agreed that it is important to hear from other schemes on this topic. The discussion focused primarily on the first stage, ‘Discover’, although examples of work being undertaken in the spheres of ‘Develop’ and ‘Deliver’ were also shared by members.

Discover, develop

Defining ESG

There was a generally-held view that Environment, the 'E' in ESG, dominates ESG investment considerations. More can be done to understand and define the social implications and issues, recognising that all three can be equally material. The term 'Responsible Investment' was deemed helpful for some members although definitions were still a challenge.

Further reading: Common Questions about Responsible Investing

Defining beliefs

There was universal agreement on the need and benefit of defining beliefs around Responsible Investment. And, while achieving consensus was recognised as important, the range of different views, within their own boards and industry, as all trustees get an opportunity to put their opinions across was also seen as valuable.

Key among these challenges:

- Authority bias, where boards are significantly influenced by a single, often doubting, voice

Introducing a structure around the discussions of ESG beliefs, for example through the use of anonymous questionnaires, was noted as helpful for teasing out the views of the board, as all trustees get an opportunity to put their opinions across.

"It's important to unveil differences in opinion and achieve consensus: make sure everyone understands the issues and has contributed to the discussion"

- Are all beliefs created equal? Whose beliefs should be sought?

"This is a topic where there is room for everyone's view and all views have value."

Trustees
Some felt it is fundamental for trustee boards to resolve their beliefs themselves – that is, before they look outside of their own board. Others felt strongly that trustees should not be leading with their own views, primarily due to their lack of expertise: investment consultants should provide guidance, as they do for other investment issues.

Scheme members
Scheme member views were a point of significant discussion. In many cases, scheme members' views are either unknown, or else not proactively sought as a key input to the process of defining a scheme's beliefs.

For some, this is because they feel scheme members are not interested in ESG. Others, particularly those representing DC schemes, felt that scheme members are interested. In part, this divergence of views might be explained by the fact DC members are taking the investment risk, where DB members are not. Demographic considerations were also suggested as a contributor to levels of scheme member interest – millennials are widely considered to be much more connected to sustainability issues than, for example, baby boomers.

Member spotlight

For one DC scheme, engaging with scheme members is a key priority and the trustees are continually challenging themselves to enhance how they do this.

"Understanding how members think, and what they think is important, is a key part of the scheme's objectives – they represent the job we have to do on their behalf."

At a recent benefit fair, they took a straw poll of members views of Responsible Investment. It revealed an overwhelming assumption and expectation by scheme members that the trustees were already investing responsibly on their behalf.

Responsible Investment practices have the potential to offer a powerful opportunity for increasing member engagement and contributions to the scheme. For example, by sharing positive investment stories with members, you give them a sense of how their money is making a difference to changing the planet for the better – engaging them around something you know they care about.

Sponsoring employers
Engaging sponsoring employers in the identification and development of the trustees' beliefs was not discussed in detail. However, it was noted that a parent company positive on ESG is often helpful.

- Perceptions that ESG integration can compromise investment performance

This poses a key challenge for many employers, who acknowledged that many members remain to be convinced by the data. Contributing to this scepticism is the fact much of the research available is sponsored or it has been conducted by academics who have a particular view. Additionally, while many make the connection between these considerations and corporate financial performance – *if you've got companies with good governance and strong ESG practices, they will likely perform better than companies that don't* – it was noted that this may not necessarily translate to investment performance.

Others suggested approaching ESG in the same way as any other investment considerations. For example, as for considerations around active versus passive investments, how do ESG investments contribute to the risk and reward profile of the portfolio? How do they sit with the broader investment objectives? Are investors any worse off by incorporating Responsible Investment considerations into the way they make decisions?

Further reading: ESG. Better Long Term Outcomes?

Member spotlight

One member highlighted the opportunity for its pension scheme to align investments around the risks identified by its sponsor – in this case, climate change. The approach of the sponsor – to use its capital to try to influence climate change – provided direction for the scheme, which adopted a similar approach. For example, energy efficiency will be an important consideration for property investments. And, in creating alignment with the sponsor's direction, it is expected that the sponsor's engagement with the scheme will remain high and positive.

Deliver
For those members in the delivery stage, several key themes emerged:

The importance of challenging fund managers
Fund managers are deemed to have vast resources in this area and there is a clear expectation among members that they are doing the right things in terms of ESG. Trustees are in a position to leverage these resources.

However, in some cases it was felt that while managers appear to have a strong story on ESG, the detail supporting it is not always fully understood. To address this, members recognised the importance of asking the right questions of managers, and investment consultants have a role to play here. Where members are doing this, and as managers grasp the importance of this to investors and the level of seriousness with which they are taking it, they are experiencing positive 'big shifts' in managers' approaches.

Further reading: Guide to Aon's ESG Ratings for Fund Managers

Using capital for good

Several members have adopted a strategy of investing their assets for good to meet Responsible Investment objectives – for example, they explore and invest in companies that are doing something positive, for instance, in the area of climate change.

Taking a cautious note, one member likened ESG to Eric Schmidt’s view of technology – that it is equal opportunity, good and bad. Through this lense, how do trustees determine good companies from bad ones? One example given included alcohol companies, which might well be avoided for the nature of their business, yet they can be very strong stewards for the environment and water in the course of running their businesses.

"If you've got good companies and good fund managers, then some of this is inherent."

Taking a non-equity route

For one member, this approach has represented their first big step towards Responsible Investment. They are focused on carbon credit and power trading and made a significant investment in 2018. And it turned out to be the best investment for the scheme, which of course helped overcome some cynicism within the board!

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