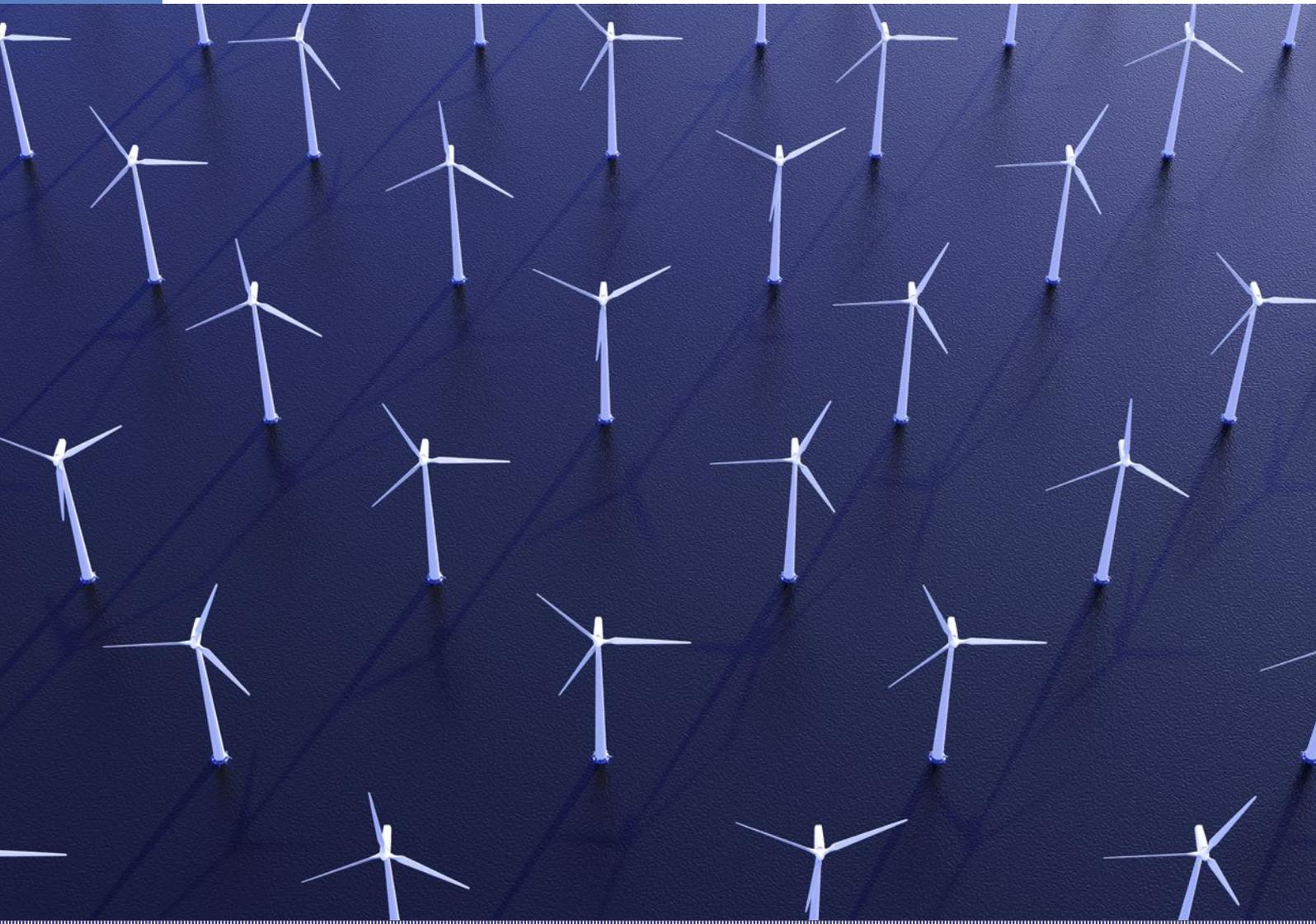


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## TOWARDS BEST PRACTICE IN ESG IMPLEMENTATION REPORTING

STATEMENT OF BEST PRACTICE  
COSTING THE EARTH

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# ACCELERATING CHANGE ON ESG AND CLIMATE ACTION

**New regulations are forcing schemes to adopt ESG at breath-taking pace**

**John Greenwood**

john.greenwood@definitearticlemedia.com



Trustees are grappling with new regulatory requirements to evidence the science behind their investment decision-making, particularly in relation to ESG factors. The new requirement to publish a Statement of Investment Principles (SIP) and an Implementation Statement (IS) has presented schemes with the challenge of gathering, processing and presenting complex information, across multiple areas of expertise, on both their intentions and their actions with regard to their investments.

So what progress has the industry made in meeting this new regulatory responsibility in an effective and efficient way?

The signs are that harmonisation of data requests is a common goal of pretty much all parts of the food chain in the delivery of workplace pensions. This is perhaps no surprise given the massive undertaking that compliance with SIP and IS obligations places on schemes.

Given the revolutionary nature of what is being asked of

trustees, the reality is that a year from now there are going to be quite a few that will have missed the target. The extent to which they could face regulatory action for breach of these new rules is a moot point. But given the novel situation we are in, I'd be betting that The Pensions Regulator is going to take a pragmatic approach. Schemes are receiving data from asset managers in different formats, nobody is precisely sure what any of it actually means, or how it compares with information from competitors, and the science of computing it into something that can be usefully implemented is in its infancy.

We are all in learning mode, but the view from across the industry is that the project is very worthwhile, and in fact should have been business as usual years ago. Pockets of scepticism are rarer to find – when it comes to ESG and climate change the pensions industry is changing, and it's changing fast.

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## TOWARDS BEST PRACTICE IN ESG IMPLEMENTATION REPORTING

# STATEMENT OF BEST PRACTICE

New rules around Implementation Statements will drive better investment practices. Greater harmonisation of data gathering will lighten the huge load being placed on the industry hears **Emma Simon**

Further industry harmonisation and consensus around standardisation is needed if there is to be a smooth adoption of new regulations on ESG reporting within the pensions market.

This was one of the key conclusions from a wide-ranging discussion at Corporate Adviser's recent virtual roundtable examining the ways the industry can meet the raft of new requirements in an more effective and efficient way.

At the core of the new regulations are requirements to disclose the way environmental, social and governance (ESG) factors have been embraced by DC schemes.

The requirement for schemes to make their Statement of Investment Principles (SIP) publicly available came into effect last year. But from this month trustees must also produce an Implementation Statement which explains how they have followed and acted on the investment policies outlined in the SIP.

This will include trustees' policies, and actions regarding 'financially material' ESG factors, including climate change.

This statement should also include details of actions taken regarding the stewardship of investments, such as exercising voting rights and engagement activities to improve ESG measures, alongside the extent to which members' views on ESG and other issues are considered when planning investments.

For trustees the challenge is gathering, processing and presenting this mountain of new complex information from asset managers and other sources, on both intention and actions in regards to ESG factors. It is a challenge providers and asset managers have also been grappling with.

### Data challenge

Consultants and providers attending the round table agreed that there was scope for further collaboration and standardisation to reduce work-load and cost, and to improve comparability of information,

and all were of the view that there were encouraging signs that the industry was moving in this direction.

Barnett Waddingham associate and policy and strategy lead Amanda Latham said the PLSA's Investment Consultant Sustainability Working Group has done a lot of ground work devising and testing templates, such as the Vote Reporting Template, which will help standardise the information requested from asset managers.

Latham said: "At the moment these are with asset managers and trustees to see if these work for them."

Hymans Robertson head of responsible investment Simon Jones agreed that the working group had started to tackle the issue of data collection harmonisation, but he says there was scope for further work in this area.

"Collaboration will lead to better practices throughout the industry, from asset managers to asset owners and investment consultants," he said.

There are obvious benefits of collaboration to asset managers, consultants and scheme providers. Jones said in the majority of cases the information requested from asset managers by different schemes will be "largely similar", so streamlining this process saves both time and money for all involved.

**Hymans  
Robertson**  
head of  
responsible  
investment  
**Simon  
Jones**



To make this more efficient though those attending the event said it would help if there was a more detailed industry-wide taxonomy so asset managers respond to questionnaires in the same way.

Jones said there has been a problem for some trustees to know how to frame questions to get the exact information they need. This working group will help resolve many of these issues, he added.

### Harmonisation call

Jones also felt there is an advantage for investment consultants if this ESG data can be collected and presented in standardised formats.

"This gives us the opportunity to move beyond these core facts and figures that are required by legislation, and really add value for the client," he said.

Those attending the event were in no doubt as to the extent of this new onerous and exhaustive governance issue for trustees. They agreed though that consultants had a vital role to play supporting trustees - as well as being a catalyst for change.

LGIM head of DC client solutions Simon Chinnery pointed out that there was an urgent need for trustees, consultants and asset manager to fully engage with these issues. "This is an issue that is not going to go away," he said. "There is going to be even more of an emphasis on ESG reporting, particularly in relation to environmental issues going forward."

He pointed out that the draft Pension Schemes Bill makes is "pretty prescriptive" about climate change, and the need for asset managers and investors to tilt towards alignment with the Paris Agreement on

(Left) LGIM head of DC client solutions Simon Chinnery and Pinsent Masons partner Mark Baker



Barnett Waddingham associate and policy and strategy lead Amanda Latham



climate change – which aims to limit global temperature rises to just 1.5 degrees.

He added: “This is just phase one. Scheme should expect increased reporting and data sharing on these issues.”

Those attending the event agreed that this regulatory move was being driven by greater consumer awareness about climate change. It has been widely cited that the ‘Greta Thunberg’ effect has resonated into boardrooms, while initiatives like ‘Make My Money Matter’ – set up by Richard Curtis to encourage greener pensions – are generating more awareness among consumers.

When Curtis launched this campaign, tweets by a host of celebrities, including Gary Lineker, helped propel pension investments out of the financial pages and onto the front pages.

### **Tough deadlines**

Given much of this data should be ready for publication imminently how ready are trustees and schemes for the forthcoming changes, and more importantly what might be the consequences be for those still struggling to put this information together?

Pinsent Masons partner Mark Baker said most schemes appear to be on track. He says his impression was that trustees are “confident” about getting the right information from their asset managers. But he said the deadlines and the amount of information needed is challenging.

Baker said it remains to be seen how The Pensions Regulator will respond when there are technical breaches.

He said: “We would hope that schemes won’t be punished for technical breaches at this stage. However, the advice is to evidence the work they are doing to comply with these guidelines. This should put them in a better position with the regulator, and should ensure they fully compliant with all the information needed for the following year.”

Latham said that there may be lessons to be learned from how the regulator has acted previously, for example when rules were introduced making it mandatory for schemes to make publish the Chair’s statement.

She pointed out that these new ESG rules sit under a different set of regulations to those around the Chair’s statement, which means the regulator will have more discretion on how it responds to breaches.

“There certainly needs to be alignment across different parts of the industry and hopefully the regulator will recognise this and see how schemes are adapting to this new regime.” ►

### Trustee hurdles

Trustees face a number of hurdles complying with this new regime. One obstacle is getting appropriate information from their asset managers on the ESG strategies being deployed. The other is to get a clearer picture of the views of their own members, and to ensure this is reflected in their investment strategy.

When it comes to the first hurdle Jones said there is some variance as to how well prepared asset managers are. The larger asset managers, particularly those with significant index tracking options are better prepared, but he says some smaller specialist asset managers are finding it more challenging to provide the correct data.

Willis Towers Watson sustainability specialists Shahrazad Khan said much depends on the asset managers own track record on ESG issues. "Actions often need to come before policy," she said.

Jones argued there is also a need for asset managers to be more transparent around all areas of stewardship, and for this information to relate to specific funds, rather than simply a "house view".

LGIM is one provider piloting new software from Tumelo that allows members to express their voting intentions on key board resolutions relating to the companies in their portfolio, offering the potential for a significant upswing in member engagement around stewardship.

### Member views

Trustees also face difficulties when it comes to surveying their own members. Jones says it is no easy task to get a clear picture of members views on a range of issues, from green energy, pollution, fair pay, tax policies, and plastic use.

Jones said: "Surveying members views has always been a tricky exercise. Levels of engagement can be relatively low, and it is difficult to know if this a fair reflection from across the membership, or the views of a smaller self-selecting vocal minority that care very deeply about these areas."

The requirement to get this information and update it regularly should prove useful he says. Technological can help in this process he says, with asset managers like LGIM offering innovative systems. "Rather than just a snapshot in time you can have ongoing feedback on which issues, or shareholder votes that members are interested in."

Providers like LGIM have said they are committed to sharing information on member surveys, which can help inform



Willis Towers Watson  
sustainability specialists  
Shahrazad Khan

trustee decisions. As Chinnery pointed out, surveys indicate a growing awareness and concern about climate change issues, particularly among younger millennials.

Khan said while this industry information is useful it should not be a substitute for schemes seeking more information about their own members' views.

"Trustees should be aware of how their own membership differs from the more general population. Their members may not be representative and may have quite different views."

### A worthwhile exercise?

The volume of data trustees now have to process may look daunting. But Khan said it is important trustees don't lose sight of the reasons why these changes have been introduced.

"This data has the potential to deliver real benefits for schemes, in terms of investment management and member engagement."

Buck principal and senior investment consultant Celene Lee said there has been a sea-change in the way the industry has come to view ESG. "A few years ago some of the clients I spoke to were adamant they did

not want me to discuss ESG options. Now they are coming to me and asking where they can get training in ESG."

This regulatory shift may be creating compliance challenges for schemes at present, but Lee says it will result in better data being collated across the industry.

"Once you collect the data, people start being interested in it and this will help shape behaviour."

Lee pointed out that the industry is now more complex and has moved away from the simple binaries of include and invest or exclude and divest. "It is not a binary but a spectrum in which companies might score well, or badly, on a whole range of measures, from carbon emissions to pollution, plastic use and fair pay policies."

She said creating an ESG dashboard that measures these metrics can help inform investment decisions. She says this isn't necessarily a case of divesting from huge swathes of the economy, but within certain sectors investing in firms that score better.

The fact asset managers have to supply this data will also put pressure on individual firms to improve certain metrics, she said, such as their carbon footprint and energy efficiency. ■



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## TOWARDS BEST PRACTICE IN ESG IMPLEMENTATION REPORTING

# COSTING THE EARTH

The cost of embracing new obligations around ESG reporting and implementation will worth paying if the pensions industry uses this new knowledge well. **Emma Simon** hears why

Pension scheme trustees, investment consultants and asset managers face tough new regulatory requirements that will compel them to generate, process and publish reams of comprehensive data relating to climate change, carbon emissions, stewardship and other ESG factors.

The bill for this extra work ultimately ending up with employers or scheme members, but those attending a recent Corporate Adviser roundtable debate on the issue were optimistic that these wide-ranging changes would deliver benefits that would outweigh their cost.

New regulations requiring schemes to publish both a Statement of Investment Principles (SIP) and an Implementation Statement (IS) stop short of mandating an investment strategy for schemes. But they do require them to publish information on what action they are taking to address 'financially material' ESG factors such as climate change.

Alongside this they will also have to detail the extent to which members' views on a whole range of ESG factors have been taken into account when constructing their investment strategy.

Round table delegates considered how the industry could move towards best practice in ESG implementation reporting.

Willis Towers Watson sustainability specialist Shahrazad Khan agreed implementing both the SIP and the related IS will be time-consuming and costly challenges for the industry. But she said this effort should not obscure the fact that these new regulations have the potential to deliver concrete benefits for schemes.

"There are a lot of hurdles to improve the data reporting around ESG. But it has the potential to deliver better outcomes for members and also improve engagement levels," she said.

LGIM senior sustainability analyst Iancu Daramus said the new data will be a useful tool for getting members more interested in their own retirement savings,

particularly if they can compare the carbon footprint of different investment strategies.

He said: "People tend to be far more engaged about issues like fossil fuels than they are about pensions."

Getting more granular data on a whole range of ESG issues should make people more engaged with DC pensions and help boost savings levels, he argued.

### Engagement through ESG

Lane Clarke & Peacock senior investment consultant Beenesh Googoolye agreed this can be an important engagement tool, particularly among younger savers. He argued that in the past there has been scepticism in parts of the industry as to whether ESG-focused investments actually do deliver better member outcomes. Delegates agreed though that these attitudes were changing.

Googoolye said that ESG issues were becoming an increasingly important issue for both trustees, and investment managers, a trend he expects to continue.

However while those attending the debate said that there was a need for greater ESG scrutiny, there wasn't a clear view on how costly implementation would be, nor who would bear the brunt of this additional governance and regulation.

Hymans Robertson head of responsible investment Simon Jones pointed out there are clearly costs involved for both trustees and asset managers in gathering and collecting the data necessary for statement preparation. His view is that at this stage it is not clear whether some of these costs will be passed on to members. But he feels it would be wrong to suggest that these costs are disproportionate.

"To my mind this is a cost worth paying. The ultimate objective of these new requirements is to improve outcomes by ensuring that trustees have more complete information on market risks and opportunities and can devise better investment strategies," he said.

He says costs will hopefully come down as the industry works to streamline and



standardise the way a lot of this data is prepared.

Those attending the panel agreed that in many ways this information should be provided as a matter of course to scheme trustees.

Jones said this ESG information should enable trustees and asset owners to challenge managers where necessary. "It will give them a more complete understanding of what investment managers are doing, it will enable them to ask different and better questions, and should make this a more constructive relationship," he said.

### Who bears the cost?

Barnett Waddingham associate and policy and strategy leads Amanda Latham said it is not clear at this stage exactly where the costs of this new initiative would fall, and this may vary depending on the size and type of pension scheme.



(Clockwise from top left) Lane Clarke & Peacock senior investment consultant Beenesh Googoolye, Buck principal and senior investment consultant Celene Lee and LGIM senior sustainability analyst Iancu Daramus

However she added: “The real benefit will be in how this data is used. Are trustees taking this information and using it to improve governance and change investment strategies? Or is this just a tick-boxing exercise for compliance?”

She said if the former is being used then the benefits could easily outweigh the cost, but not if trustees were simply going through motions in order to meet minimum regulatory standards.

Latham cited an example of how this data can help improve investment strategies. These may be quite small changes that could potentially deliver significant rewards. For example she pointed out the extent to which the FTSE100 index is overweight in fossil fuels. She said this is mainly due to the way this index is constituted. But including a carbon tilt, away from these industries could significantly improve a scheme’s ESG rating, help control risk and add value for investors.

While the present challenge is gathering and presenting this data, the real opportunity comes in how trustees use this information in future.

Jones argued that there is a key role for investment consultants to play here in supporting trustees and so adding value.

### **Engaging members**

When it comes to improving engagement, Jones pointed out that this covered more than just engaging scheme members.

He says these new regulations should also promote better engagement between trustees and their investment managers and also greater engagement between investment managers and the companies they ultimately invest in.

Greater disclosure of information and publication of data should foster better decision-making through both of these channels.

Buck principal and senior investment consultant Celene Lee argued that the very process of collecting and capturing this data should help change behaviour, both at an individual and corporate level.

She cited the example of NatWest which recently devised techniques to measure an individual’s carbon footprint. Once people know this information they tend to alter their behaviour to lower the score, she said.

The same principles apply to pension investments on a wider scale. What gets measured gets managed. She said those schemes that embrace the spirit as well as the letter of these new regulation will derive the most benefit.

Lee pointed out that the regulatory regime isn’t happening in a vacuum but reflects wider global shifts in policy, regulation and consumer awareness about climate change. The pension industry has no option but to move with this changing broader agenda, she argued, adding that the ramifications for different pockets of the industry would be far-reaching.

### **Passive versus active**

“The world is changing around us. But this shift will change other debates within the investment industry, such as the active versus passive debate, and the decision whether to invest in listed or private markets.”

As she points out those investing in unlisted investments may have more influence on how these organisations are run. This can mean more attractive ESG characteristics. “Over time this focus on ESG will change the way capital flows,” she said.

“Governance is part of this process - all schemes clearly need to comply with these new requirements. But some will go further and this has the potential not only to deliver better outcomes for members over time but bring about societal change.”

Jones added: “Asset managers need to have more information to hand. They world is changing and it is important to not lose sight of why this legislation has been introduced, it is for better outcomes: be they financial, societal or environmental.”

Khan agreed it is crucial not to lose sight of these longer-term benefits. “It may seem like the compliance costs outweigh any immediate benefit,” she says. “But pensions are long term savings plans and clearly have a role to play in shaping the society of the future,” she said.

“The silver lining is to recognise the real value of this process, how this should accumulate over time and help promote more sustainable investment strategies.” ■

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## OPINION

# ESG, EASY AS 1,2,3: PRACTICAL STEPS FOR MEETING INCREASED DISCLOSURE REQUIREMENTS

» **Simon Chinnery** Head of DC Client Solutions LGIM and **Iancu Daramus** Senior Sustainability Analyst, LGIM

As trillions of dollars flow into sustainable investments and high-carbon assets are written down by oil companies, environmental, social and governance (ESG) themes are influencing investment decisions on an ever-increasing scale and affecting companies' access to capital.

Against this backdrop, pension fund trustees now face increased regulatory scrutiny about how they take financially material issues into account, including ESG considerations.

Following on from the changes to occupational pension scheme reporting requirements which came into force in October 2019, trustees must:

- Review, enhance and publish their statement of investment principles (SIP) by 1 October 2020
- Include an implementation statement based on the principles outlined in their SIP in their scheme's annual report after 1 October 2020, if they oversee a defined contribution (DC) or hybrid scheme
- Develop an implementation report on their voting and stewardship policies by 1 October 2021 if they are responsible for a defined benefit (DB) scheme

Below, we tackle three of the key questions that are likely to emerge during the process:

1. How are schemes managing financially material risks and opportunities, including from ESG issues?
2. To what extent are members' views (on non-financial factors) taken into account?
3. How can trustees better understand and explain the voting and stewardship activities conducted on the scheme's behalf?

### **Living in a (financially) material world: Managing the risks and opportunities**

The regulations coming into force are not necessarily intended to alter schemes' invest-



LGIM senior sustainability analyst **Iancu Daramus**

Regardless of the type of investment mandate they have chosen, trustees should review the stewardship activities undertaken by their designated asset managers

ment decisions. Trustees who are satisfied that ESG issues have been sufficiently covered under existing arrangements for managing material risks and opportunities may wish to state this explicitly in their SIP and implementation statements.

Some trustees wish to target investment outcomes further than existing processes allow – for example, by adopting an investment mandate with an explicit goal of a reduction in associated carbon emissions, or other positive ESG characteristics. This decision may be motivated by considerations of financial risk and return, but it may also reflect members' views on sustainability issues.

LGIM head of DC client solutions Simon Chinnery



Regardless of the type of investment mandate they have chosen, trustees should review the stewardship activities – such as voting and engagement with companies and policymakers – undertaken by their designated asset managers.<sup>1</sup>

#### **Don't just show me the money: Scheme-member perspectives**

The updated regulation also addresses scheme members' non-financial preferences. Here, there are several things to consider: what are members' preferences, where do they want them incorporated, and how? Is the asset manager aware of and incorporating members' views into its investment decisions?

Our research found that scheme members are increasingly engaged with ESG issues. It's encouraging that our findings included people of all ages affirming that they would engage more with their pensions if they felt that they were making a positive impact.<sup>2</sup>

One dimension of impact is the positive influence that investors can have on investee companies, and thereby on society as a whole, through their stewardship activities.

#### **Hop, SIP and a jump: Supporting the enhanced disclosure of schemes' stewardship activity**

When addressing the increased disclosures, a good place to start is to think about the spirit of your scheme's approach to stewardship, before you formulate the detail of what your voting policy will be.

Questions to keep top-of-mind are: how your approach links to your asset manager's policy, how your manager defines the 'most significant' votes, what the approach to

conflicts of interest is, how your asset manager collaborates with other investors and their members on ESG issues, and how your voice can be heard even in a pooled fund.

#### **Here to help:**

In an increasingly stringent regulatory environment, LGIM is playing our part in trying to steer the market towards better practice. In 2020, ShareAction ranked LGIM number three of the world's 75 largest asset managers across responsible investment themes, and as one of only five managers to be placed in the top category (A).<sup>3</sup> ■

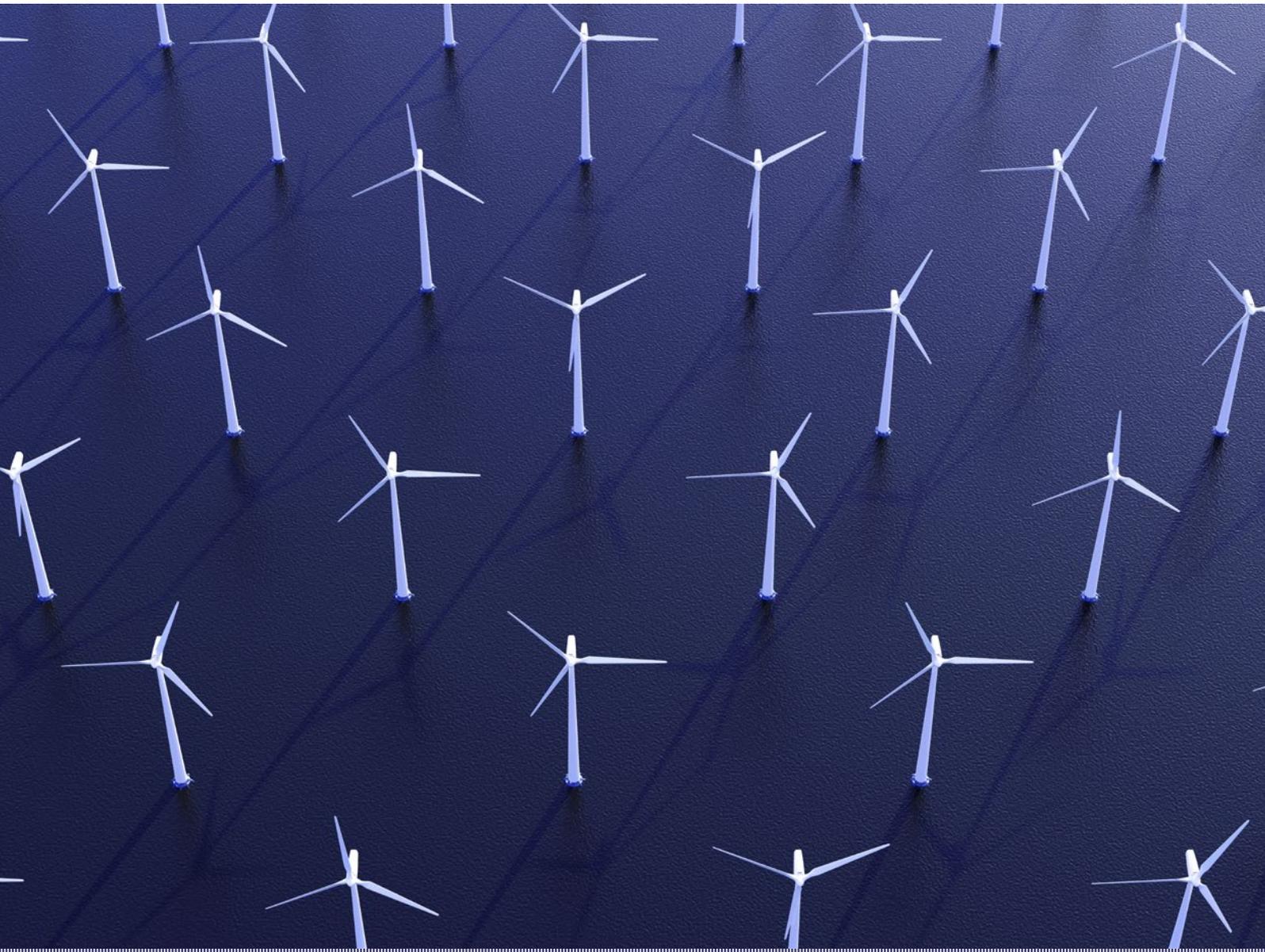
**The full guide, including links to LGIM-published documents to explain our disclosures, is available here <https://www.lgim.com/uk/en/insights/our-thinking/esg-and-long-term-themes/esg-checklist/>. Please get in touch with your usual L&G contact for more tips on how we can help you to meet regulatory requirements.**



<sup>1</sup> For more information on updating the SIP, please see: [http://www.lgim.com/web\\_resources/lgim-thought-leadership/Files/Client\\_Solutions\\_five\\_step\\_esg\\_checklist\\_trustees\\_Mar\\_19\\_UMBRELLA.pdf](http://www.lgim.com/web_resources/lgim-thought-leadership/Files/Client_Solutions_five_step_esg_checklist_trustees_Mar_19_UMBRELLA.pdf) <sup>2</sup> A survey of c.1000 workplace-pension savers was conducted by LGIM in 2019. More information is available here: <https://update.lgim.com/dc-esg> <sup>3</sup> Source: "Point of No Returns: A ranking of 75 of the world's asset managers approaches to responsible investment", ShareAction, March 2020 (<https://shareaction.org/research-resources/point-of-no-returns/>).

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