expert insight

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INDEPENDENT TRUSTEE

Environmental investments


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I was recently invited to join a round table discussion at the UK Sustainable Investment and Finance Association (UKSIF) conference in Edinburgh. The discussion was to be about pension scheme investments and climate change with the slightly ominous title of 'What's taking them so long?'. In the pursuit of greater knowledge and understanding, I accepted.

I am not a denier; I accept that climate change is real and that the industrial world is responsible for the pace of change. I also see how the position could be improved through targeted investments but, a trustee has been entrusted with other people's assets for a purpose. In the case of a defined benefit (DB) pension scheme, that purpose is to fund their pension promise.

My position was and remains steadfast:

1. Trustees are required to be prudent; we are not guinea pigs; we should not jump on bandwagons and; we should not be early adopters
2. Trustees should follow an integrated risk management process with investment decisions based on the risk profile afforded by the funding position of the scheme and the covenant of the sponsor
3. Ethical or environmental concerns must always be secondary; a trustee can only take such matters into account if the investment is financially sound

If we add in the need to consult with employers, education of trustees, availability of suitable products; it is no shock that environmental concerns are very far down the investment agenda of most trustee boards.

Local Government schemes have woken to the issue but their obligations, regulatory requirements and investment powers are very different.

It is no surprise that the sustainable investment community is interested in UK Defined Benefit pension schemes. According to the Security and Sustainability Green Paper they hold £1.5 trillion under management (i.e. 75% of the UK GDP) with 60% of those assets held by only 4% of the schemes. The vast majority of schemes are small, the majority of trustee boards just don't have the time, governance or risk budgets to consider Environmental, Social and Governance (ESG) matters in any detail.

Of course, a DB pension scheme's investments are required to be appropriate to the nature and duration of its liabilities. Many pension liabilities have duration beyond the expected feasibility of fossil fuels so it is argued that trustees should be considering investing in post industrial alternatives. However, such long term durations are either used to defend riding the equity growth train or matched with long term Government debt. Therefore, as so much of pension scheme assets are tied up in Government debt perhaps it would be more effective to lobby Government for investment – they are undoubtedly better placed to cover the investment risk. Equity investment should take care of itself; if it's a good investment then managers will select it.

Trustees must also consider the diversification of their investments, mitigating risk by holding a diverse uncorrelated portfolio. For schemes large enough to manage their investments direct, perhaps they should be directing some of that fund to environmentally aware investments but, for the majority of funds diversity can only be obtained via pooled investments in unitised funds.

I can't help but think that trustees are the wrong people to lobby; you have to convince the managers and consultants that environmentally aware investments are a good enough bet to include them in their investment vehicles; then you have to convince consultants and advisers that environmentally aware investment funds are good enough investments for them to consider and advise on; only then will the issue reach the trustee agenda.

For defined contribution (DC) schemes it should be purely a question of supply and demand. If members want access to socially, ethically and/or, environmentally aware funds they should have them. If your scheme is too small to offer a suitable diversity of choice, perhaps its time to consider if you have the right DC model.

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