Pensions Management Institute

Knowledge

In association with BMO

BMO Global Asset Management

Navigating the continued evolution of ESG in pension schemes

Welcome to the results of the latest ESG Survey from the Pensions Management Institute in conjunction with BMO Global Asset Management.

Foreword

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While ESG has risen rapidly up the agenda of boards on both sides of the trustee-sponsor relationship, it is clear that the rate of change, while necessary, has made it very challenging to keep pace. The pressure to make the changes required by society, and increasingly by regulation, as quickly as possible has both eroded the confidence of decisionmakers that they are fully on top of the issues and simultaneously placed an increased reliance on the support of advisers.

In collaboration with the Pensions Management Institute, and with the support of its members, we have undertaken this research report to try to understand the full extent of this lack of confidence, identify the barriers that still need to be overcome and consider some practical solutions to improve things. Our goal, clearly, is for the industry as a whole to be better equipped to meet the challenge of ESG and, more specifically, TCFD compliance.

We hope that you find our findings interesting and thought-provoking and that they might prove something of a catalyst for further discussion.

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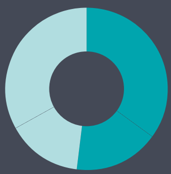
It is clear from even the most cursory glance at the press that ESG has become one of the hottest topics of discussion. From the largest corporates to individual consumers, we are all having to consider our impact on both the environment and society at large. Pension schemes and their trustees are no exception. Through this survey, we have sought to gain a better understanding of schemes' readiness to meet the impending ESG-related regulatory and reporting changes and the issues that are still to be overcome.

A snapshot of the key findings is as follows:

Introduction

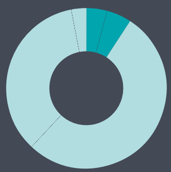
- Over **53%** of respondents indicated that ESG and climate change were "high" on their trustee board's agenda, up from just over 29% who felt it was high on their agenda prior to the launch of the Department for Work and Pensions' consultation. It is of concern, however, that just under 11% admit that ESG still remains low on the agenda.
- Meanwhile, one in five PMI members polled **(20%)** is not at all confident in understanding the impending TCFD reporting and just under **19%** have not received training to ensure they have the appropriate degree of understanding of climate change risks and opportunities.
- Almost half of trustee PMI members polled **(48%)** felt that the board they sit on is only set up to deal with "some aspects" of ESG and the impending regulatory changes.
- Over **89%** of respondents felt confident they would be able to put in place adequate governance structures to meet the impending TCFD reporting rules within the required timeframe.

The new world order – are we taking this seriously?



53%

The percentage of respondents who felt that ESG and climate change were "high" on their board of trustees' agenda.



11%

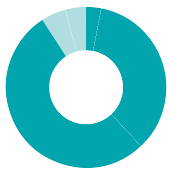
The percentage of respondents who felt that ESG and climate change were "low" on their board of trustees' agenda.

The Covid-19 pandemic has been a hugely challenging time, particularly so for boards on both sides of the covenant relationship. For some, the threat will have been existential, for others just an area of serious concern. What is clear is that **it will have dominated significant amounts of both management and trustee time**. Against this backdrop, however, trustees will also have had to find time for their normal activities, whether navigating a new triennial fund valuation, considering any number of de-risking options in the market, or simply undertaking good member communications. Time will also have had to be found **to consider ESG and its legal and social requirements**.

In this context, it may then come as less of a surprise that our survey found that just over half of those polled **(53%)** consider ESG and climate change to be **"high"** on trustees' agenda up from just under a third **(29%)** who felt that it was "high" on the agenda prior to the DWP's consultation launched last August. While the move is a swing in the right direction, there were still just under **11%** of respondents who felt that it was "low" on their board of trustees' agenda. **(Before the launch of the consultation less than a year ago, over 30% considered it low on their board of trustees' agenda.)**

Despite this apparent apathy, there is still a sense that it will be "alright on the night" with **89%** of respondents confident they will be able to put in place adequate governance structures for their scheme boards to meet the impending TCFD reporting rules. Clearly, a good approach to ESG is more than adherence to legal disclosure requirements, but it does suggest a sense of denial in the extent of the task ahead. What is clear is that **there will certainly be a degree of reliance placed upon third parties** to get them where they need to be.

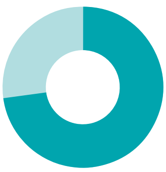
Many service providers recognise this challenge and within the pensions industry, ESG is evolving rapidly as a target area for new revenue, but as with all these things, there are those providers who do it well and those who are simply repackaging their existing offer. **Greenwashing has entered the vernacular** and is something that we all need to watch out for. As new regulation comes down the track, trustee boards will need support to find the appropriate help to be compliant.



89%

The percentage of PMI members polled who were confident they will be able to put in place adequate governance structures for their scheme boards to meet the impending TCFD reporting rules.

An industry-wide issue – who is responsible for what?



73%

The percentage of respondents who rely on investment consultants for their scheme's adherence to the myriad of ESG responsibilities.

Given the weight of support behind developing a more socially and environmentally responsible financial system, **it is no surprise that ESG is a consistent topic of discussion** across virtually all third-party service providers' marketing activity.

There is undoubtedly a lot to play for. Our research shows that nearly three-quarters of respondents **(73%)** rely on investment consultants for their scheme's adherence to the myriad of ESG responsibilities. This is a significant responsibility being laid at the door of the consultants but also a very significant opportunity for them. It also perhaps goes a little way towards explaining the earlier point about the priority of ESG on trustee agendas. **"We don't need to spend too long talking about it as our consultant is taking care of things for us."** Trustees need to be mindful that the buck stops with them if things don't go to plan – regardless of how far removed they are from the actual investment at the end of the process.

There is also something of a paradox here, as our research also shows that **25%** of respondents are not confident that their investment managers are holding their underlying investments to account for net-zero emissions targets. **One has to ask the question what could be behind this?** The most likely explanation is that it is not one single thing but rather a combination of factors. It may be that trustees don't know what questions to ask of their managers or perhaps that the reporting they receive from their service providers is not consistent. It could be the complicated nature of their investment set up or a lack of standardised reporting.

Whatever the reasons, the solution has to result from a combination of greater transparency and disclosure by all those involved in the investment chain and recognition on the part of trustees that they are ultimately responsible for the way that scheme assets are invested or brought to bear in the pursuit of positive change.

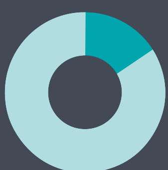
25%

The percentage of respondents who are not confident that their investment managers are holding their underlying investments to account for net-zero emissions targets.

Trustee skills – are we ready?

20% **not at all confident**

The percentage of respondents who are "not at all confident" in understanding the impending TCFD reporting.



19%

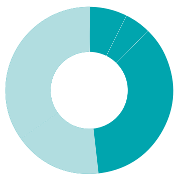
The percentage of respondents who have not received, or even been offered, training to ensure they have the appropriate degree of understanding of climate-change risks and opportunities.

Trustees have evidently had a lot to grapple with over recent months and while one might want to give them some breathing space, like any job there is a requirement to keep up to speed with what is going on. **By their very nature, professional trustees will typically take a more proactive approach** to this through accreditation and CPD but lay trustees, particularly those without any financial incentive, may be less inclined to invest the time needed to stay on top of all the issues and developments required by schemes today. Regardless of perspective, however, **the fiduciary responsibility remains the same;** while trustees have had to deal with a lot, that doesn't abrogate their legal and social responsibility with regards to ESG.

Our research shows some quite concerning data here. One in five PMI members polled **(20%)** is **"not at all confident"** in understanding the impending TCFD reporting with almost two thirds **(65%)** only "somewhat confident". Given this situation, one might have thought that these schemes would be seeking to address this in short order, ideally through courses in collaboration with the likes of the Pensions Management Institute. Yet **19%** of respondents to our survey have not received, or even been offered, training to ensure they have the appropriate degree of understanding of climate-change risks and opportunities. Given the stakes, this has to be addressed as soon as possible.

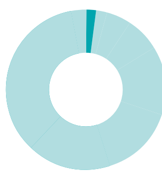
While trustees are personally responsible for the appropriate governance of the schemes on which they sit, like any board there is a collective element to consider. **A good board will boast a range of complementary skillsets**, such as member-nominated trustees giving the board insight into what is going on the shop floor, or other professionals such as accountants or lawyers from within the middle/senior management functions of the sponsor. Even sole trustees typically rely on a team of people standing behind them. Against this backdrop, it is perhaps of some further surprise that almost half of those PMI members polled **(48%)** felt that the board they sit on is only set up to deal with some aspects of ESG and the impending regulatory changes. Include the more than **2.5%** of respondents who felt that the board of trustees on which they sit is not set up at all to deal with these changes, then that is over half of respondents.

If trustee boards are not set up to deal with all aspects of ESG and the impending regulatory changes, it is because **ESG is now really an expected capability** among third-party providers, (and typically a capability highlighted by these providers). We must consider then how can they do a better job to ensure trustees have confidence in meeting their ESG requirements?



48%

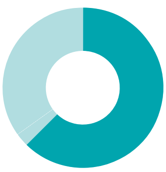
The percentage of PMI members polled who felt that the board they sit on is only set up to deal with some aspects of ESG and the impending regulatory changes.



2.5%

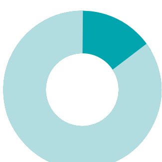
The percentage of respondents who felt that the board of trustees on which they sit is not set up at all to deal with these changes, then that is over half of respondents.

Barriers – what obstacles are still to be overcome?



61%

The percentage of members polled who claimed to see "material obstacles" to implementing ESG policies in pension-fund investing.



17%

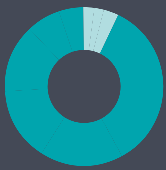
The percentage of respondents to our survey who cited a lack of products and services as a material obstacle to implementing ESG policies in pension-fund investing

So is there anything that providers of products and services to trustee boards can do collectively to improve matters? **Six in ten PMI members** polled **(61%)** claimed to see **"material obstacles"** to implementing ESG policies in pension-fund investing, including **25%** of respondents who believe a lack of evidence of the financial performance of ESG investments is the biggest hurdle. Indeed, **17%** of respondents to our survey cited a lack of products and services as a material obstacle to implementing ESG policies in pension-fund investing – despite the market already being awash with ESG products. Reflecting on the earlier points in this report, **almost one in ten respondents (9%)** cited a lack of knowledge or understanding as a material obstacle.

What we have here is confusion about both products and capability. Clearly the hygiene factor is that managers should be integrating ESG into every product they offer as standard simply as part of their own ESG capability. They may then also offer products targeting specific ESG outcomes (e.g. sustainable equities.) Trustees need help to understand both their own need and the product required.

Given the sheer volume of products in the market, it might seem strange that there isn't something that meets most requirements out there, if one knows what one is looking for. **It may be that trustees are simply overwhelmed** with the options in the market.

It seems that transparency and disclosure are once again at the root of many of these issues. If products are clear about what they are, how they work and how they perform, then **trustees should be in a better position** to be able to compare apples with apples in the search for the most suitable product.



9%

The percentage of respondents who cited a lack of knowledge or understanding as a material obstacle.

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