



The SPP member research series:

Putting ESG into practice

Pension schemes in the UK are facing increasing scrutiny and pressure from government and regulators, their members, campaign groups and the public at large on Environmental, Social and Governance (ESG) issues. During 2019 new regulations came into effect which require pension schemes to set out how they take account of ESG factors in their Statement of Investment Principles (SIPs), and act as responsible owners of the assets they invest in. The requirement to publish the SIP on an open website will only add to the scrutiny.

Wider pressures on pension schemes to deal with environmental issues have included an Institute and Faculty of Actuaries (IFoA) Risk Alert raising awareness around the financial risks posed by climate change, and both the House of Commons Environmental Audit Select Committee and Guy Opperman asking the trustees of the largest UK pension schemes to publicly explain how they manage ESG and climate change risks.

In light of these pressures, the SPP conducted a survey of its membership in November 2019, covering pension professionals from a range of disciplines, to try to understand what they were seeing in practice on ESG matters. Our findings are summarised in this paper.

Regulation catalyst for change

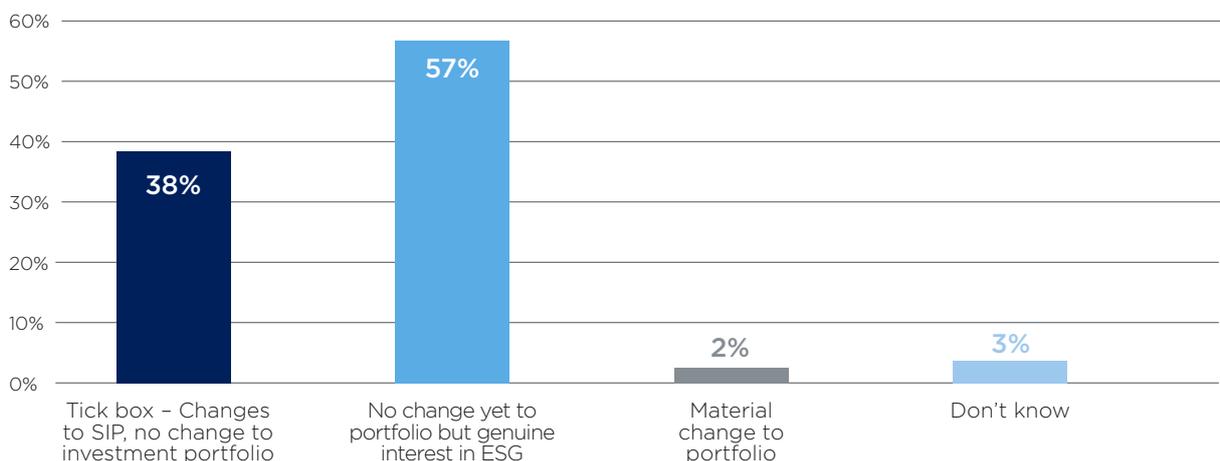
A key finding from the survey is that ESG matters are an ongoing and growing concern. It has gained greater momentum this year, with regulation

seeming to be the biggest catalyst for change. However, the survey has raised some key questions. Who should be driving and influencing ESG change in the pension industry, and would ESG still have momentum in the absence of regulation? It seems that the industry as a whole still has some way to go to decide its role in driving forward ESG issues.

Actions to date

Although schemes are now required to have a policy around ESG, the acid test is whether that leads to any change in investment strategy. We therefore asked our members what approach and changes they have seen in practice (Fig. 1). 57% of respondents said that although there is genuine interest in ESG no changes to portfolios have yet been made. 38% of respondents are seeing a majority of clients only reacting to the regulatory change as a tick box exercise, solely making changes to the SIP to comply.

Fig. 1 Which best describes the approach taken by most of your clients:



In hindsight, the limitations of this sort of question are clear – in asking our membership what they are seeing most often, the results are skewed towards the most common approach. If all our members see 60% taking no action and 40% taking action, then 100% of responses would indicate “taking no action” as the most common approach. These results can therefore not be taken as an indication of what percentage of schemes are taking action.

Nevertheless, the fact that almost all our members report that no change to the portfolio is the most common approach they have seen is significant (Fig. 1). It is, admittedly, early stages for many schemes and having reflected their ESG stance in the SIP, it may take some time to see that through.

In the meantime, anecdotal evidence from some of our members is that changes are certainly taking place – some schemes are changing investment strategies and others are changing the governance processes around such decisions e.g. introduction of an ESG committee. A specific committee is more common amongst the larger schemes than smaller schemes but inevitably best practice will trickle down over time. In certain public sector schemes, the council's target for carbon neutrality has caused them to review the carbon's footprint of their pension assets and take decisive action.

Drivers for Change

The drivers for ESG investment are complex, not least because the concept itself is multi-dimensional. We therefore asked our members what they felt were the key drivers behind ESG. We asked this in two distinct (but related) ways.

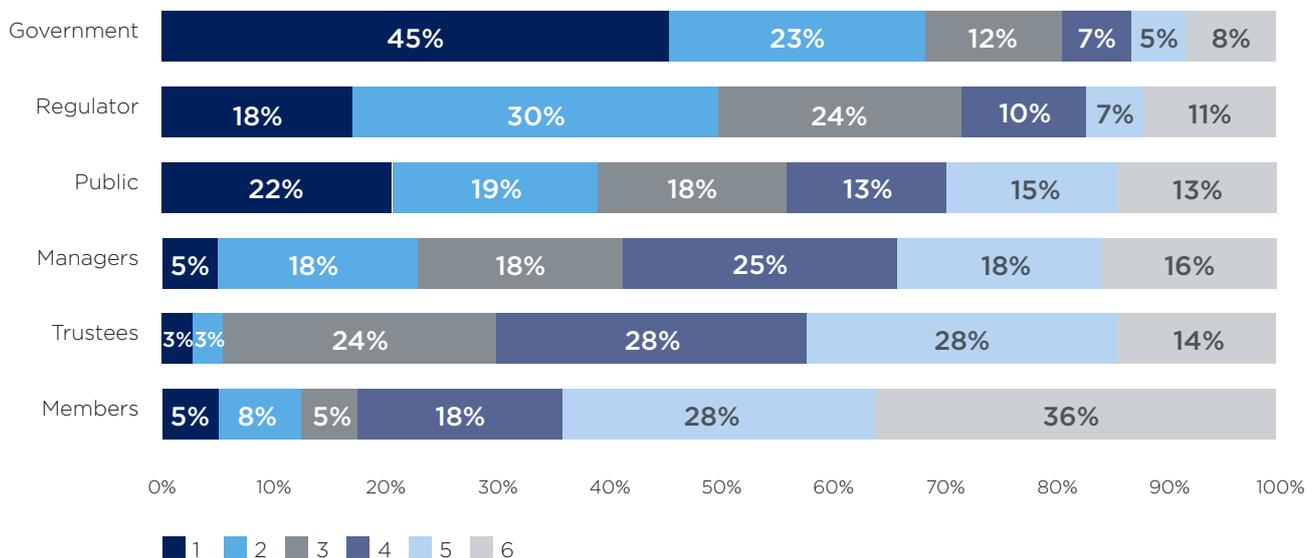
- First, the Who – which party was most influential in causing change to be made?
- Second, the Why – what factors have most influence on the decision to make change?

While the results of the two questions give a similar message, beneath the surface are some more interesting conclusions.

Drivers for Change - Who

We asked our members to rank different parties in order of their influence on ESG strategy (one being most important through to six being the least important). Given the recent changes in regulatory requirements it would be surprising if the Government were not at the top of the list. The range of responses however show a more nuanced picture (Fig. 2).

Fig. 2



It seems perverse for the actions of a pension scheme to be influenced more by the general public, to whom it has no duty to as opposed to its members, to whom it has a legal responsibility.

The significance of the role played by Government and the Regulator cannot be overstated, with over 65% placing one of those parties as most influential, and almost 55% placing one of them second.

The difference between the impact of the public and pension scheme members is quite stark. Almost 22% of respondents cited the public as the primary influencer and over 70% placed the public in their top 3 influencers, compared to just 5% and less than 20% respectively for the influence of pension scheme members. The increased visibility of environmental concerns over the last year is no doubt a key factor, but it seems perverse for the actions of a pension scheme to be influenced more by the general public, to whom it has no duty as opposed to its members, to whom it has a legal responsibility. Sadly, this probably simply reflects the well-known inertia of pensions scheme members combined with a lack

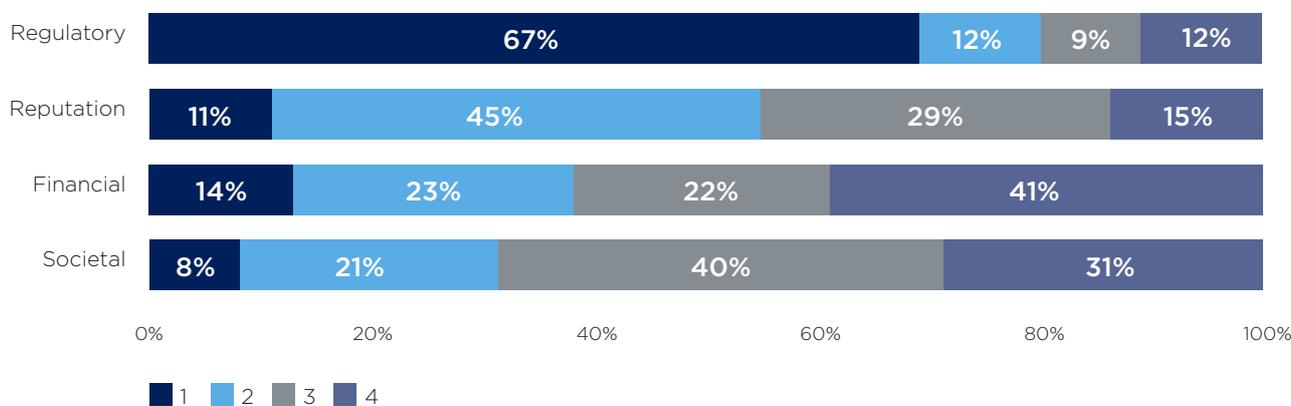
of understanding that they could have an impact on sustainability through their pension arrangements.

While not a leading influencer, investment managers are seen to have more influence than members in the round, but notable is the view that the trustees themselves are least influential. While that appears surprising at first, perhaps it is reasonable that the personal opinions of the trustee board are not the main driver, but the views of their advisers, members and regulators.

Drivers for Change - Why

Our second question about drivers asked our members to rank the reasons why ESG was influencing strategy (one being the biggest influence through to four being the least). Consistent with the previous question, the primary driver was regulatory requirements, see Fig. 3.

Fig. 3



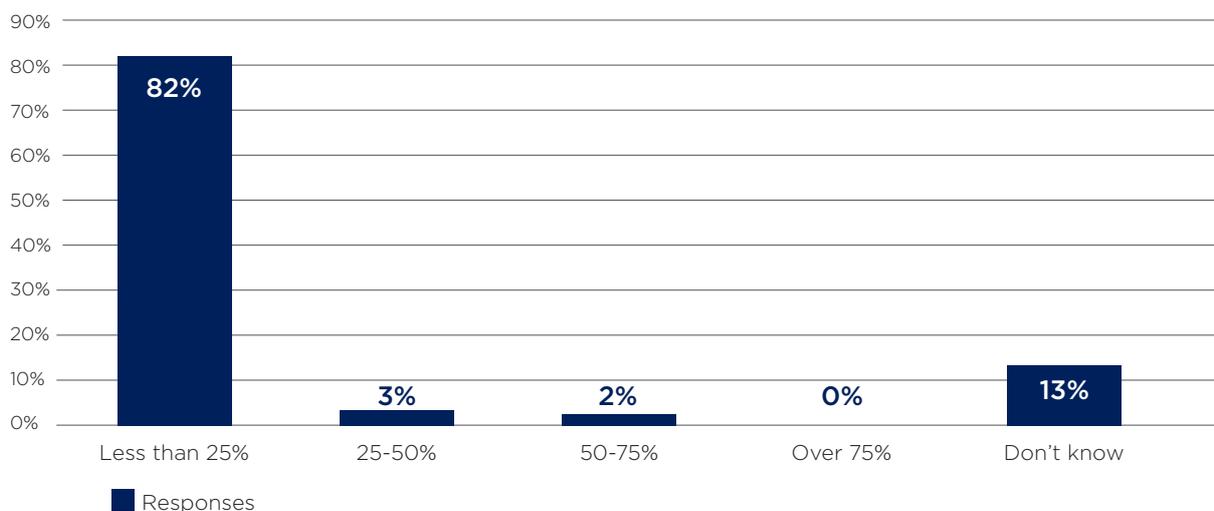
The Government and the Pensions Regulator (TPR) are seen as the main drivers of ESG policy, so it is not surprising regulation also dominates this question. But beyond the regulatory driver there is a mix of other reasons.

What is reassuring is that in aggregate around 20% of those surveyed felt that financial or societal drivers were the most important, representing a clear minority of schemes who are adopting ESG for fundamental reasons rather than because someone else is expecting them to do so.

What do members think?

While legislation now requires trustees to have a policy in relation to ESG, the requirement to consult with scheme members and develop a statement on member ESG views was an idea that was removed from the proposals during the consultation stage. We asked SPP members what proportion of their schemes had consulted on scheme member views. The response was almost unanimous, see Fig. 4 overleaf.

Fig. 4 In your experience what proportion of schemes have sought members' views on ESG:



While a small proportion of our members have seen schemes seeking member views, 82% of respondents said in their experience less than 25% of schemes had sought their members' views on ESG. Clearly further data would be required to draw any firm conclusions, but based on responses given we expect the actual proportion to be well under 10%.

As with many other aspects of this survey, the issue may be timing. Given the requirement to have a compliant SIP by the December 2019 deadline, we expect many schemes have focussed on being compliant, and will consider seeking scheme member views in the future.

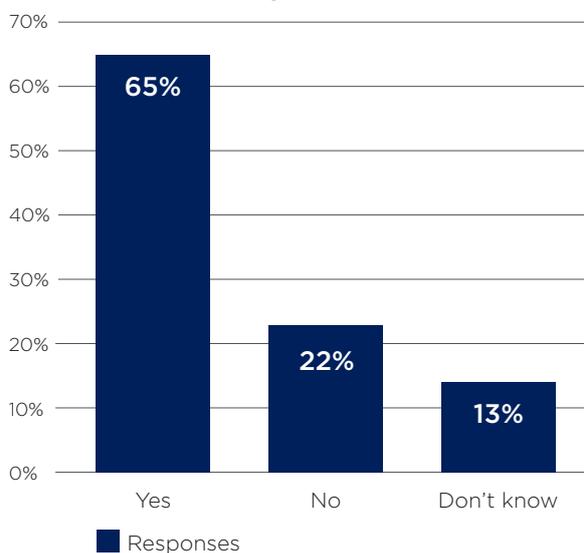
DC Defaults

Up until this point, all of the questions we asked our members related to their experience of what schemes are doing. In this final question we asked respondents for their own views - whether DC schemes above a certain size should have a range of ESG funds for their members.

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While the most popular view was clearly "yes", not all of our members agreed, see Fig. 5.

Fig. 5 Should DC schemes above a certain size be required to offer a range of ESG funds that are suitable at different stages of a member's life?



It is interesting that the results to the previous questions indicated the key driver behind ESG change has been regulation. Yet in this final question, where an opinion on what should happen is required, rather than a view on what actually is happening, most pension professionals clearly come out in support of ESG, at least in relation to DC scheme choice.

Conclusion

This survey has highlighted that the pension industry appears to be reacting to regulatory and government pressure, as well as to public opinion to some extent, rather than driving the ESG agenda. That said, anecdotally there is a growing interest and emphasis on ESG, which gives the impression that perhaps it is just early days.

35% of respondents felt that financial considerations were either the first or second most important factor in considering ESG, with the pensions world becoming increasingly focused on the idea that ESG credentials may be a significant driver of future success and it's a risk that should be ignored at one's peril.

If enthusiasm for ESG in practice can be embedded across pension professionals and trustees, then regulatory pressure will gradually become less important. In the short-term, however, the regulatory regime is essential to ensure that ESG is a long-term change and not just a short-term flurry of activity.

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