Q2 2020

Responsible Investment update

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COVID-19 and ESG

Is there still room for Responsible Investment?

The current COVID-19 pandemic is testing governments and investors alike on their conviction and ability to carry through on commitments and actions on sustainability and stewardship. The FT's 'Moral Money' team sum up the potential divergence nicely — *"cynics might argue that the current crisis makes ESG issues irrelevant; optimists retort that this adversity is forcing us all to rethink our values and the purpose of business and finance."*

We may be biased, but it is clear to us that this pandemic has highlighted how companies are exposed to various non-financial risks (many of which are significantly more likely to occur than a global pandemic!) and heightened the responsibility of investors to ensure that their investments are well positioned against such risks[1].

Observations of ESG performance in the recent downturn

It is also worth noting that during this downturn, we have observed that ESG indices have generally outperformed[2]. Some of that performance divergence is simply down to the drop in oil price; but equally the tilt to higher quality companies within ESG indices explains some of the resilience. Either way, we should be careful not to hang our hat on such short periods of returns, and it should not detract from the longer-term thesis of the added value in considering ESG factors.

[1] https://www.wsj.com/articles/coronavirus-pandemic-could-elevate-esg-factors-11585167518

[2] https://www.linkedin.com/pulse/green-brown-transition-time-crisis-remy-briand/

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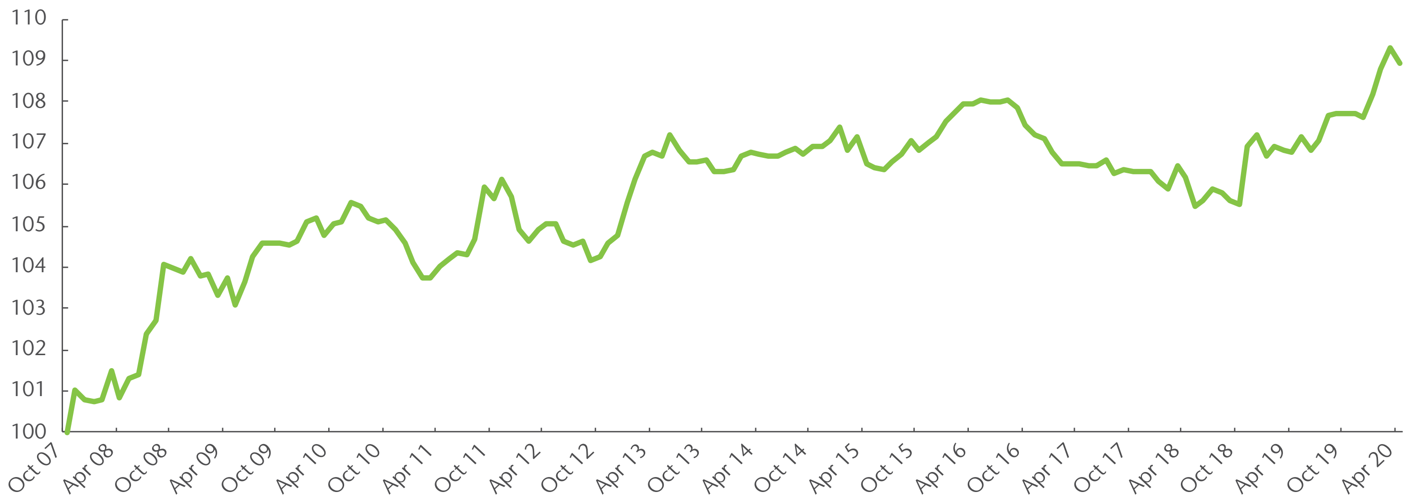
MSCI ACWI ESG Leaders index relative performance as of April 30, 2020



Source: MSCI

We will explore more of these themes in an upcoming blog on ESG performance during the downturn.

Action required – SIP changes

Statement of Investment Principles changes by 1 October 2020

As outlined in our Technical Note in June 2019, legislation aimed at encouraging transparency and long-term shareholder engagement was transposed into UK law in June 2019. Broadly speaking, the regulations require the SIP to be expanded to cover policies on:

a) Arrangements with asset managers to align with trustees' policies and to incentivise decisions which contribute to long-term performance including engagement.

b) How costs and performance are monitored and evaluated, in particular a focus on portfolio turnover costs.

These requirements are non-trivial and for many schemes require developing new explicit policies in relatively new areas. The extension of the requirement to publish the SIP to DB schemes opens up the potential for SIPs to be subject to much more scrutiny than they have in the past.

Our recommended approach for developing the new policies is to ensure that the views of all the trustees are collected, including those of the sponsor if appropriate, on the issues that are relevant to the regulatory requirements, covering Responsible Investment, stewardship and costs. This enables the development of more bespoke policies that capture the views of the trustees as a whole, and will help with preparing a SIP that can stand up to a greater degree of public interest.

Other UK Regulation and Guidance

Consultation on draft guidance from the pensions climate risk industry group (PCRIG)

Following the launch of the government's Green Finance Strategy in July 2019, The Pensions Regulator co-established an industry group[3], which includes Aon, to develop guidance for trustees to evaluate how climate-related risks may affect their pension scheme strategies and plans; and to report on this in a consistent and transparent manner[4]. The draft guidance, which was issued for public consultation in March, explores climate-focused practices around scheme governance, risk management, scenario analysis, and disclosure. Trustees have the opportunity to respond during the consultation period, which closes on 2 July.

In his Ministerial foreword, Guy Opperman referred to the Government expectation that by 2022 all large asset owners would be disclosing in line with the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD). This guidance is important to support trustees with "the necessary skills and knowledge" as "more and more pension schemes move towards TCFD reporting voluntarily".

Please let us know if you would like to discuss a response to the consultation or if you have any questions about using the guidance in the context of your scheme.

[3] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/820284/190716_BEIS_Green_Finance_Strategy_Accessible_Final.pdf

[4] Pg 10 of draft guidance

Pension Schemes Bill[5]

The Pensions Scheme Bill continues to evolve. The Government have proposed the insertion of a new clause that may require pension scheme trustees to publish certain information about the effects of climate change on their schemes (which may include assessing the impact on assets, outlining the trustees' strategy for managing these risks, and measuring against targets determined by the trustees). Statutory guidance will be separately developed by Government and consulted on in due course. We will continue to provide updates on this as more becomes known.

The UK Stewardship Code 2020

At the Aon RI Network event in November 2019, Claudia Chapman and David Styles of the Financial Reporting Council spoke about the substantial revisions to the Stewardship Code. They reflected on how the investment market and opportunity for engagement across asset classes has developed. Asset owners and asset managers who want to become signatories to the code are required to produce an annual stewardship report explaining how they have applied the code in the previous 12 months[6].

Claudia and David are interested to hear from and speak to trustees or their boards. Please let us know if you would like to learn more.

To learn more about our network and to receive invitations to future meetings, please get in touch.

PSLA launches Stewardship Guide and Voting Guidelines 2020

The Pensions and Lifetime Savings Association (PLSA) recently published the Stewardship Guide and Voting Guidelines 2020 to better support scheme investors to understand 'how to do' stewardship, and the role exercising a vote plays in this framework.

The guide outlines key considerations for schemes in building effective stewardship, engagement and voting policies, including practical checklists and a glossary of key terms. There is also information on how to assess corporate behaviour and governance overall; as well as voting guidelines that go through each of the key issues to investors (such as audit, remuneration and climate change) and explore what investors should look for from companies.

The PLSA acknowledges that many pension schemes outsource the day-to-day stewardship of the scheme to asset managers and other service providers but expects that this guide will support schemes in their responsibility to monitor their service providers and challenge where necessary.

EU Developments

Technical Expert Group (TEG) publishes two key reports on sustainable finance

In March, the TEG published its Final Report on Sustainable Finance Taxonomy and a Usability Guide for an EU Green Bond Standard.

The EU Taxonomy is a tool to help investors understand whether an economic activity is environmentally sustainable[7]. It sets performance thresholds for economic activities which make a substantive contribution to one of six environmental objectives and avoid significant harm to other environmental objectives.

The EU Taxonomy will help companies and issuers access green financing to improve their environmental performance as well as help identify which activities are already environmentally friendly. In so doing, it will help to decarbonise high-emitting sectors and grow low-carbon sectors[8].

Financial market participants and companies will be required to complete their first set of disclosures against the taxonomy, covering activities that substantially contribute to climate change mitigation and adaptation by 31 December 2021. The expanded set of disclosures covering activities that substantially contribute to six environmental objectives will be required by the end of 2022[9,10].

For more information on using the taxonomy, including a helpful video, see the PRI website here.

Usability Guide for an EU Green Bond Standard (GBS)

The guide contains the TEG's recommendations for the European Commission (EC) to consider; from how to identify eligible green projects through to how to implement reporting of a green bond. The EU GBS would be a voluntary label for bonds for issuers and enhance transparency, comparability and credibility of the green bond market, encouraging market participants to issue and invest in EU green bonds[11,12].

The draft model of the EU GBS, developed by the TEG, will form the basis of the consultation. Following evaluation, the EC will publish its decision on whether a legislative approach will be pursued and what form the final EU GBS should have[13].

More information on green bonds can be found here.

[5] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/871772/aligning-your-pension-scheme-with-the-TCFD-recommendations-consultation-guidance.pdf

[6] https://www.frc.org.uk/investors/uk-stewardship-code

[7] https://www.unpri.org/eu-taxonomy

[8] https://ec.europa.eu/info/sites/info/files/business_economy_euro/banking_and_finance/documents/200309-sustainable-finance-teg-final-report-taxonomy_en.pdf (At a Glance page)

[9] https://www.unpri.org/eu-taxonomy-final-report-2020-starts-a-decade-of-action-on-climate-change/5547.article

[10] https://ec.europa.eu/info/sites/info/files/business_economy_euro/banking_and_finance/documents/200309-sustainable-finance-teg-final-report-taxonomy_en.pdf (Page 26)

[11] https://www.regulationtomorrow.com/eu/eu-sustainable-finance-expert-group-issues-final-report-on-taxonomy-and-guide-on-green-bonds/

[12] https://ec.europa.eu/info/sites/info/files/business_economy_euro/banking_and_finance/documents/190618-sustainable-finance-teg-report-overview-green-bond-standard_en.pdf

[13] https://ec.europa.eu/info/sites/info/files/business_economy_euro/banking_and_finance/documents/200309-sustainable-finance-teg-green-bond-standard-usability-guide_en.pdf

Research

Innovative Study on a Virtual Investment Experiment — Understanding consumer demand for sustainable investing

The University of Cambridge Institute for Sustainability Leadership produced a research paper based on an innovative study on how investor decision-making behaviour is influenced by the availability of information on the environmental and social impact of funds alongside standard financial data.

Overall, the study demonstrates that public interest in sustainability does influence investment preferences when suitable information is provided. Combined with increased policy and regulatory attention on sustainable finance, this points to an opportunity for financial institutions and intermediaries to consider how they can meet a large-scale (and latent) consumer demand for sustainable investment.

For pension funds, this indicates the opportunity to use themes connected with sustainability to better connect and engage with their membership.

Aon releases Impact Investment Paper

The opportunity to seek positive, measurable impact on investments in addition to a competitive financial return is apparent and demand is growing as companies and members alike look to more avenues to demonstrate corporate/individual responsibility.

In this paper, we show how:

- The role of impact investing is growing quickly.
- Trustees looking to optimise financial returns and have an impact on solutions for the future should look to invest in companies that seek sustainable solutions.
- Environmental and climate change concerns feature strongly in impact agendas, alongside more localised objectives.
- The United Nations Sustainable Development Goals (SDGs) are supporting investors in how they direct and measure their impact, and address challenges with data.
- A broad approach towards impact investing in public equities will be attractive, combining managers who favour solution providers with those who focus on engagement impact.

Please let us know if you would like to hear more about investing for impact.

Further reading

- Sackers on ESG and Climate Change
- Pensions for Purpose
- Big Society Capital
- Portfolio Institutional ESG Hub

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About Aon

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