

Sackers ESG survey for pension schemes

August 2019

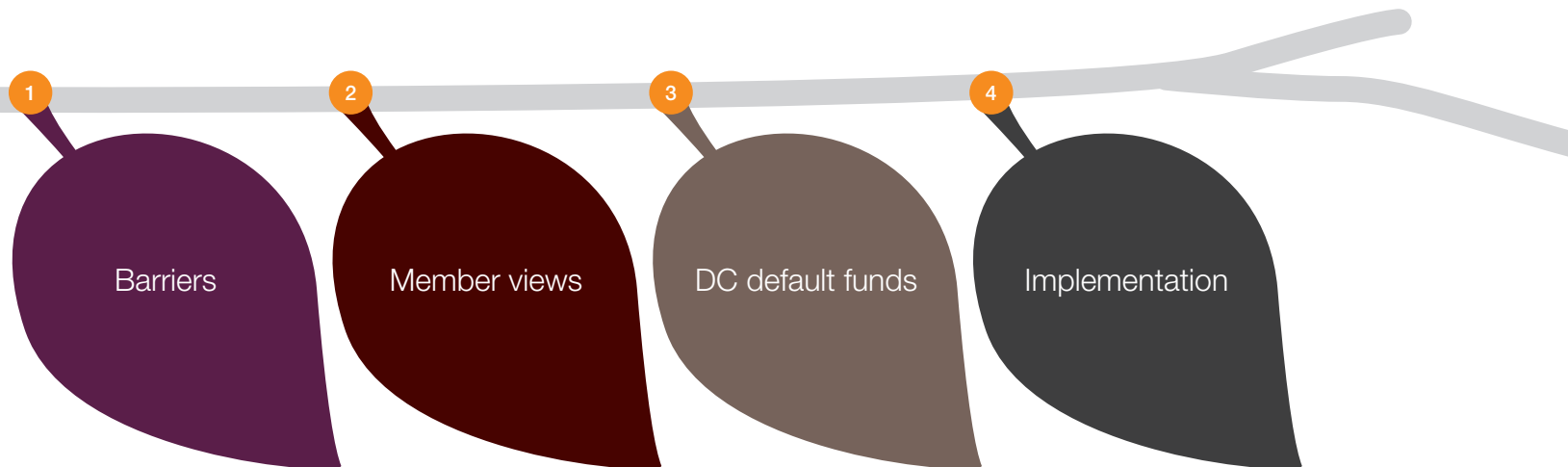
Summary report – key themes and Sackers views



Introduction

In July 2019 we surveyed 102 trustees and pension scheme managers to gain a better understanding of what pension funds are doing, or intending to do, in response to the various new and updated regulations surrounding environmental, social and corporate governance (ESG) factors in investing, and how important they view these factors for their schemes.

Whilst it is reassuring to note that 94% of respondents consider that ESG and climate change issues are important to pension schemes, the responses received indicate a range of views, from which we have extracted four key themes:



1 Barriers

Material obstacles to implementing ESG policies still exist

We asked whether there were material obstacles to implementing ESG policies in pension fund investing. The following three areas emerged as being the most problematic:

- lack of evidence of financial performance of investments (48%)
- lack of time and/or resource to consider fully (33%)
- lack of products in the market place (28%)

Comments referred to “crazy levels of regulation” and “a considerable time and resource burden”, with several respondents pointing out that ESG is just one risk that trustees have to manage.

Nearly a fifth of respondents also cited lack of clear investment advice, with one respondent commenting on “confusing terminology for ESG, responsible investing etc used by consultants and managers alike”.

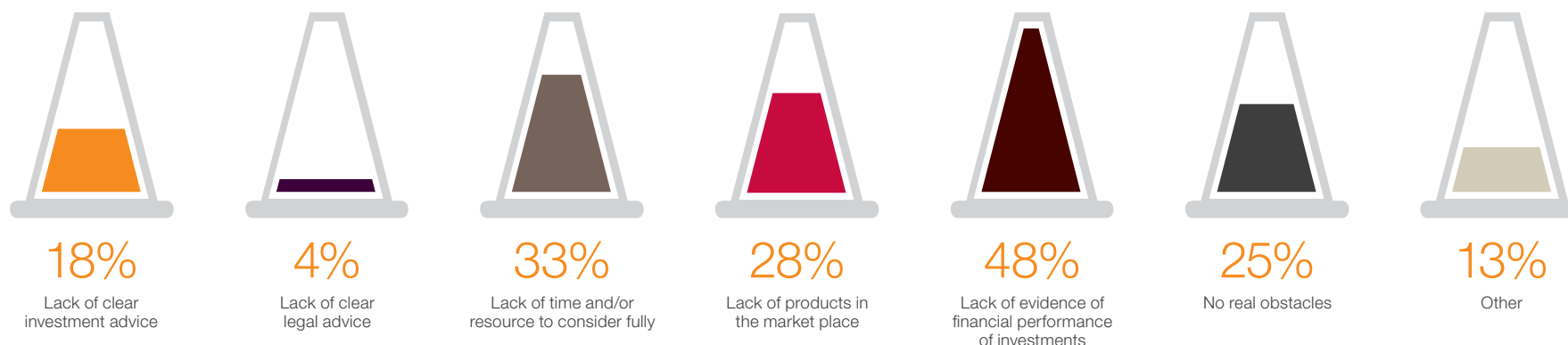
However a quarter of respondents do not consider there to be any material obstacles.

“ Sackers view

In our trustee guide to [ESG and climate change for pension funds](#) we emphasise the need for trustees to exercise a scheme’s investment powers for proper purposes and in accordance with a “prudent person” test. When reviewing their scheme’s investment policy and SIPs, trustees must consider what actions a prudent trustee would take. We would caution against trustees being too reliant on past evidence of financial performance when considering forward-looking risks such as climate change.

Looking ahead into the unknown is difficult though, and it is hard to argue with trustee’s concerns that there are no easy approaches or answers. Undoubtedly the market will develop but in the meantime advisers and managers should lead the call for clear advice and terminology.

Q: Have you found any of the following to be material obstacles to implementing ESG policies in pension fund investing?



2 Member views

Still lots of confusion about the extent to which trustees should take account of member views

40% of respondents feel that clarity in relation to trustee fiduciary duties is still lacking. This lack of clarity is particularly evident when considering the responses in relation to the level of influence that member views should have on trustees' approach to ESG, an area of continuing confusion.

Over a third of respondents felt that DB investment strategies should be influenced by member views, with the proportion increasing to over 75% for DC default funds.



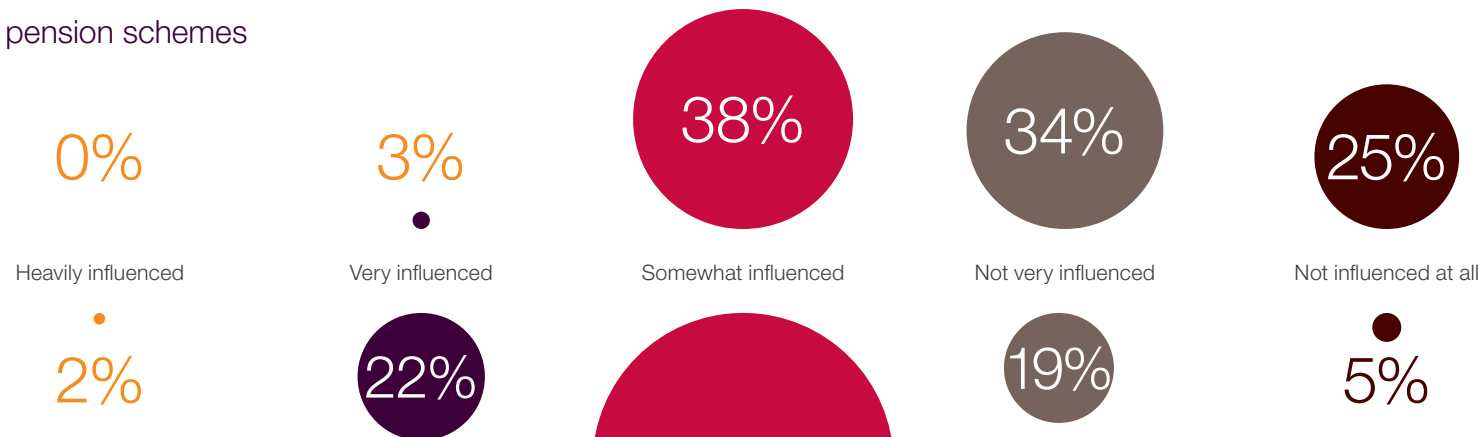
Sackers view

That member views are more important in DC than DB schemes seems instinctively right, given that in a DC scheme the member (rather than the sponsor) will be underwriting the investment risk. It must also be right that trustees will wish to have a range of investment options on offer in a DC scheme that will cater to different members' preferences. However, within DB investment strategies and DC default funds, where **trustees are required to exercise their investment powers in accordance with strict legal fiduciary duties**, trustees must be careful not to confuse "accountability" to their membership with a perceived obligation to do what some members might want.

The primary focus of trustees is necessarily a financial one, namely to invest DB assets in a manner consistent with delivering members their defined benefits. And in a DC scheme, trustees should focus on constructing a DC default fund that the trustees judge to be in the best financial interests of the members invested in it. As we note in our trustee guide to [ESG and climate change for pension funds](#), there is no doubt that this should include a consideration of ESG and climate change issues as financial factors. However, **members' ethical preferences which are non-financial in nature are a secondary consideration and one which the law only allows trustees to take into account in strictly limited circumstances.**

Q: Should trustees' approach to ESG be influenced by member views in relation to DB pension schemes or DC default funds?

DB pension schemes



DC default funds

3 DC default funds

Schemes are not doing enough to take ESG factors into account

The survey responses indicate that integration of ESG into DC default funds is lagging. Less than a fifth of respondents consider that DC trustees are doing enough to take ESG factors into account, particularly when contrasted with DB funds, where over a third of respondents feel that trustees are doing enough.

“ Sackers view

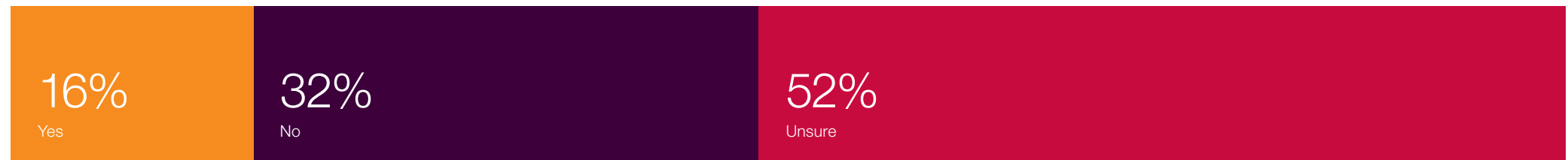
It is concerning that confidence that ESG factors are being sufficiently taken into account in DC default funds is so low. This also seems at odds with the fact that this is where most new member contributions are now going and such members probably have a much greater long-term financial exposure to ESG issues, particularly climate change. Having said this, that DC schemes are lagging behind DB schemes is not surprising given that the investment toolkit for a DC trustee is much smaller, with DC

default funds generally following passive investment approaches constrained by costs and charges limitations.

It is ironic that the regulatory requirements for DC schemes are more stringent and come in sooner than for DB schemes. In reality, only the development by investment providers of a greater number of low cost funds with deeper ESG integration, and demand from DC trustees for such products, will improve the picture for DC members.

Q: Are trustees doing enough to take ESG factors into account for DB pension fund investment or in their DC default funds?

DB pension schemes



DC default funds

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Implementation

A work in progress?

Despite the areas of continuing uncertainty identified by respondents throughout the survey, 85% have updated or will update their statement of investment principles (SIP) for compliance purposes in response to the changes in [Investment Regulations](#), with over half involving their advisers.

Almost three-quarters have undertaken or will undertake trustee training on ESG, with over half documenting or intending to document a bespoke responsible investment policy and/or statement of beliefs.

However, only 13% have made or intend to make material changes to their investments following the review. This may

suggest this is largely a paper-exercise at present. It is also apparent from respondents' comments that there is a degree of scepticism around the impact trustees can have in this area:

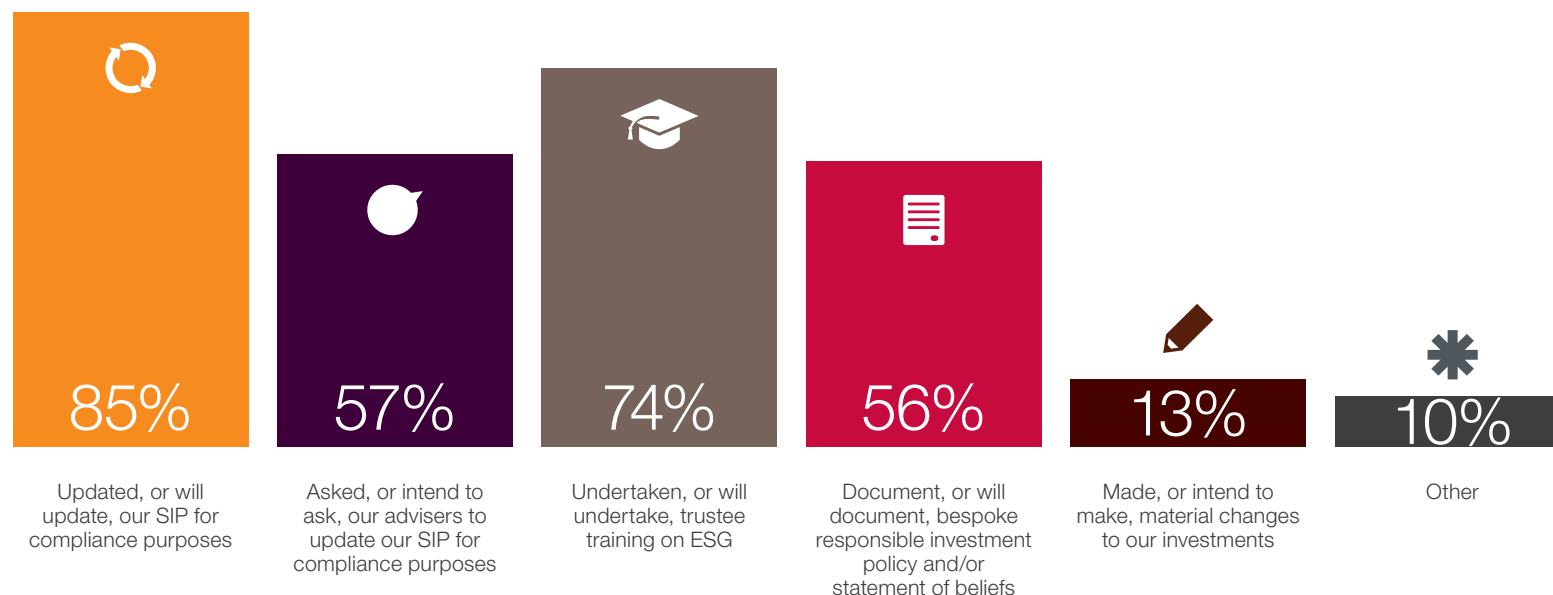
“ Too much emphasis on ESG risks becoming a tick box compliance matter.

“ ESG seems to be a rather woolly area – an awful lot of the “green” bonds we see are just greenwash.

“ Sackers view

The most interesting response is that only 13% of trustees expect to make a material change to their investments, but this outcome should not be surprising. While it is possible that some trustees feel that they are already doing enough, for others integrating ESG into the scheme's investment strategy is a longer-term project, and not something that could be meaningfully accomplished by 1 October 2019. This response also reflects a frustration that successive changes to the SIP requirements push trustees to “box ticking” compliance, distracting from the work needed to make material changes, which by their nature will take longer to achieve.

Q: In response to the changes in the Investment Regulations we have done, or will do, the following:



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Implementation cont.

A work in progress?

The vast majority of schemes (84%) rely on their managers when it comes to stewardship of their investments, through voting, monitoring and engaging. They either expect managers to have an appropriate policy for trustees to regularly review, or to engage based on the trustees' policy and report on it. Respondents did comment however on the difficulty of active engagement when it comes to fiduciary management.

With new **Regulations** published in June 2019, requiring further changes to SIPs from 2020, as well as annual reporting of trustee stewardship activities and public disclosure of SIPs, it is to be expected that almost two thirds of schemes are taking advice to update their policies. Almost one fifth of schemes are not planning to consider the further requirements until they have dealt with the 2019 SIP changes and the comments reflect that respondents believe there is yet more to come.

“ ESG is an issue without boundaries, so will probably grow and grow in importance.

“ The new investment regulations are enabling trustees to challenge the investment managers, however, we must be realistic about the likely speed of changes.

Q: Our approach to stewardship of our investments, through voting, monitoring and engaging, is:

53%

We expect managers to have an appropriate policy of their own which the trustees review regularly

31%

We expect managers to engage based on the trustees policy and report on this to trustees

7% We leave it to our managers

5% We have appointed, or intend to appoint, an overlay manager

2% We engage directly

2% Other

Sackers is the UK's leading commercial law firm for pension scheme trustees and employers. Over sixty lawyers focus on pensions and its related areas, including Sackers finance and investment group, a team of lawyers who provide cutting edge advice to trustees, employers and providers on all aspects of pension scheme finance and investment.

We advise on the development and implementation of ESG strategies consistent with trustee fiduciary duties and the development of trustee ESG and engagement policies, including how to document Trustee responsible investment policies and related wording for a scheme's SIP. We also provide ESG training for trustees and pension scheme providers.



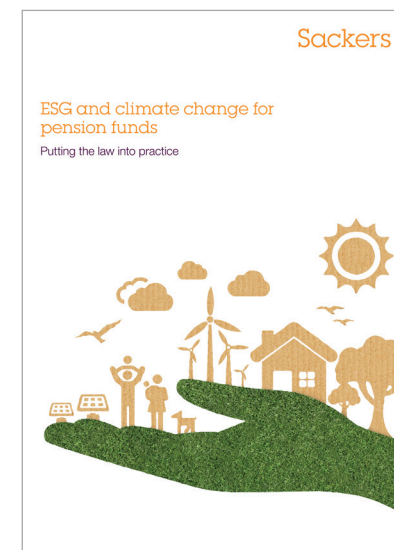
For further information and advice on ESG and climate change considerations for UK pension schemes, contact [Stuart O'Brien](#) or [Ralph McClelland](#) or your usual Sackers contact. You can also visit www.sackers.com/ESG, where you can download a copy of our sample [regulatory timeline](#) and [ESG guide](#).

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