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➤ Sustainable investment approaches and challenges for Trustees

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Any views and opinions are those of the investment manager, unless otherwise noted.

Agenda

- Introduction
- Sustainable Investment Approaches
- Regulation
- Practical Steps for Trustees

INTRODUCTION

The why and what that lies behind ESG

We live in a world of transition

These changes impact investment



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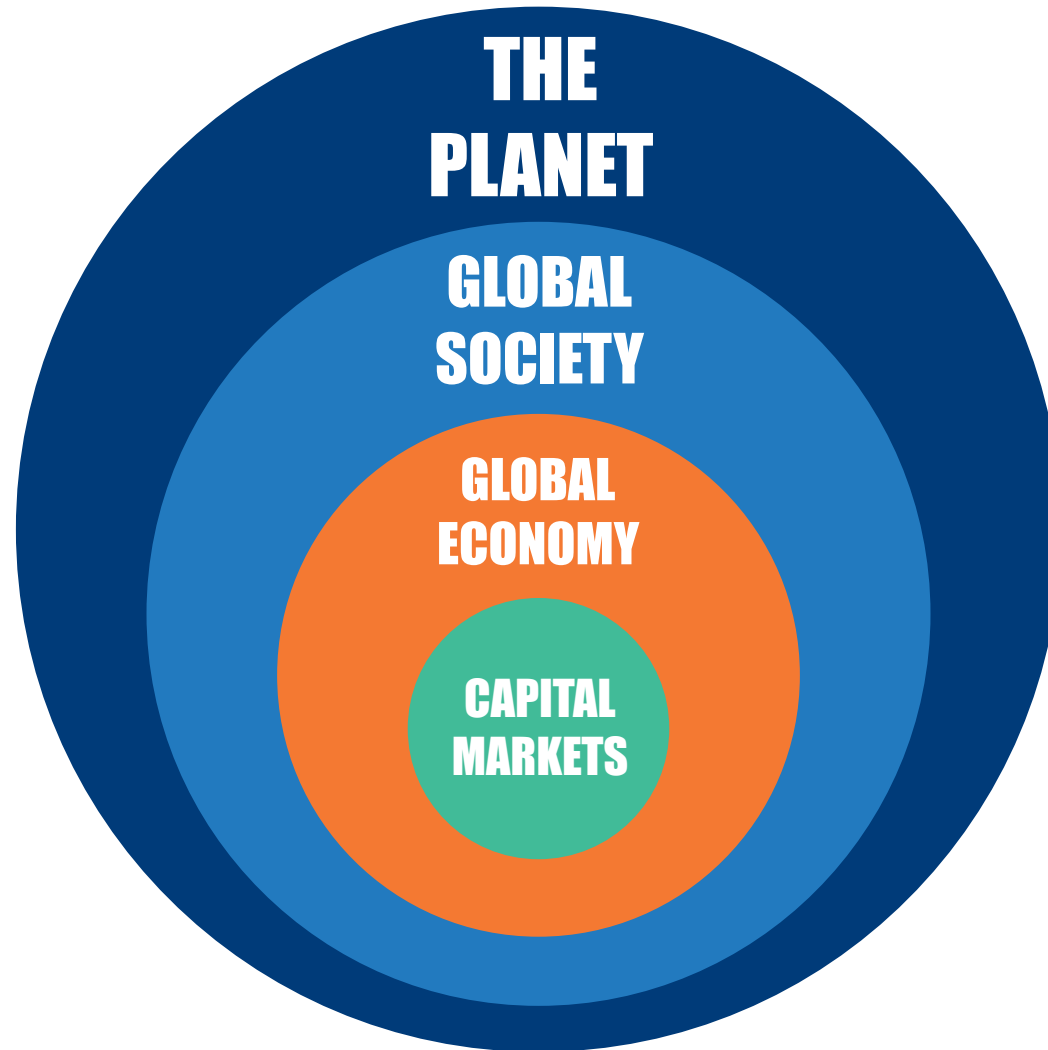
The health of ecosystems on which we and all other species depend is deteriorating more rapidly than ever. We are eroding the very foundations of our economies, livelihoods, food security, health and quality of life worldwide.

”

Intergovernmental Science-Policy Platform on Biodiversity and Ecosystem Services, May 2019

A complex, interconnected system

We are all in it together



A sustainable & resilient system

Environmental and social issues

“Non-financial information” is a misnomer

ENVIRONMENT

- GHG emissions
- Air quality
- Energy management
- Water & wastewater management
- Waste & hazardous materials management
- Ecological impacts

LEADERSHIP & GOVERNANCE

- Business ethics
- Competitive behaviour
- Management of the legal & regulatory environment
- Critical incident risk management
- Systemic risk management



BUSINESS MODEL & INNOVATION

- Product design & lifecycle management
- Business model resilience
- Supply chain management
- Materials sourcing & efficiency
- Physical impacts of climate change

SOCIAL CAPITAL

- Human rights & community relations
- Customer privacy
- Data security
- Access & affordability
- Product quality & safety
- Customer welfare
- Selling practices & product labelling

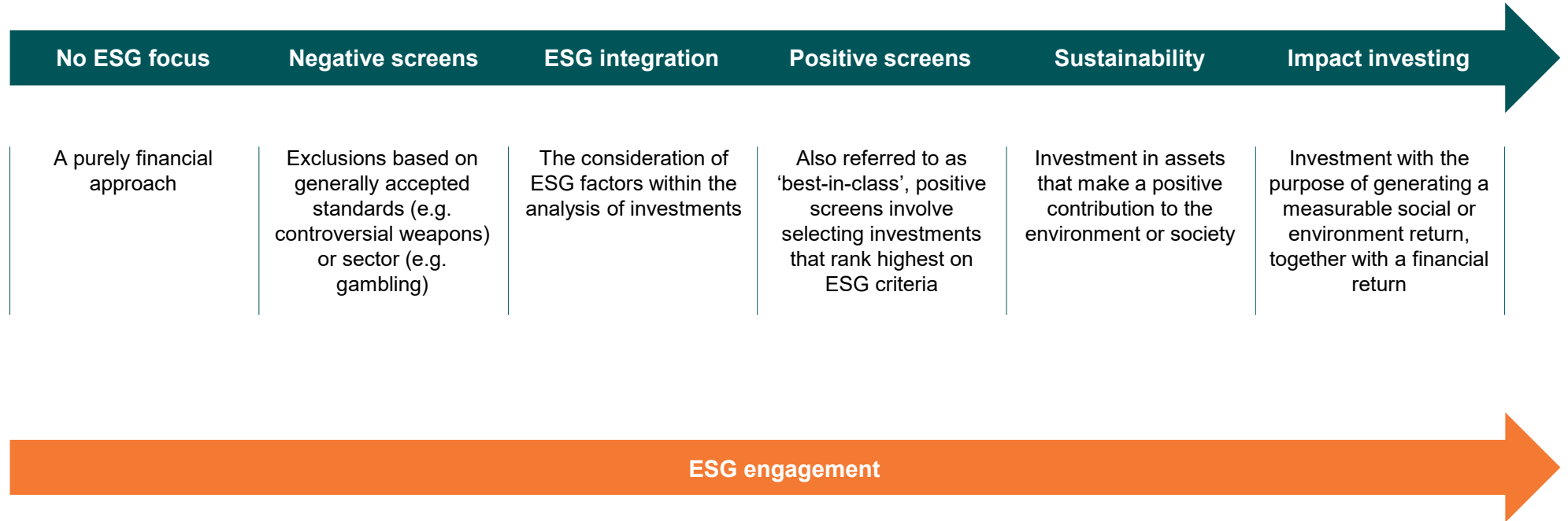
HUMAN CAPITAL

- Labour practices
- Employee health & safety
- Employee engagement, diversity & inclusion

Fundamental inputs

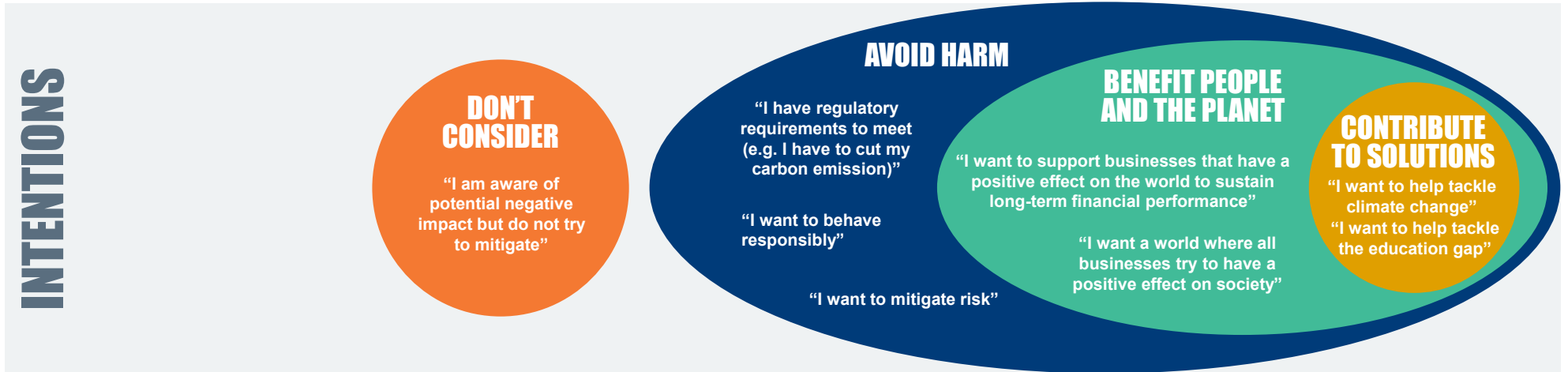
SUSTAINABLE INVESTMENT APPROACHES

One size does not fit all

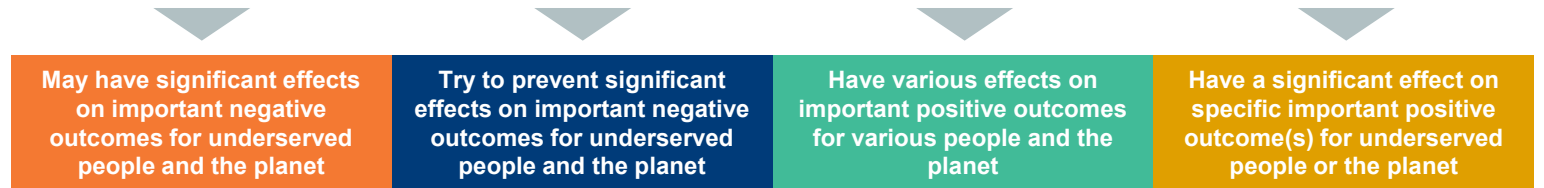


Also known as stewardship, ESG engagement includes shareholder voting and integration with company management on ESG issues, with a view to influencing practices. We are always stewards of people's money, therefore engagement is an activity that should be undertaken irrespective of the designation of the strategy

The impact investing spectrum



Businesses' goals across the 5 dimensions of impact	WHAT	Important negative outcomes	Important negative outcomes	Important positive outcomes	Specific important position outcome(s) AND deep, and/or for many and/or long-term AND Underserved
	HOW MUCH	Various	Marginal and for few	Various	
	WHO	Underserved	Underserved	Various	Underserved
	CONTRIBUTION	Likely same or worse	Likely same or better	Likely same or better	Likely better
	RISK	Various	Various	Various	Various



The UN sustainable development goals

Ambitious, complex & detailed



169 TARGETS

Each of the 17 goals has a set of specific targets, which identify the focus areas per goal.

231 UNIQUE INDICATORS

Each of the 169 targets has at least one indicator, which helps to tangibly measure progress towards SDGs.

“

The Sustainable Development Goals (SDGs): A universal call to action to end poverty, protect the planet and ensure that all people enjoy peace and prosperity.

”

REGULATION

A coercive approach

INTENDED TO PROVIDE A COMMON REFERENCE POINT WHICH SHOULD HELP END GREENWASHING

Applies at a product level

- Intended to capture ESG funds broadly
- Products that do not invest in environmentally friendly activities must include a disclaimer stating that the relevant investments “... do not take into account the EU criteria for environmentally sustainable investments.”

Compliance deadlines

- 31 December 2021 for first set of financial products disclosure requirements
- 31 December 2022 for second set

A changing regulatory landscape

170+ ESG REGULATORY PROPOSALS GLOBALLY IN 2018 ALSO – BUT EU’S LEADING THE WAY



A changing environment for pensions

Tightening regulatory & legal requirements

UK DWP INVESTMENT REGULATIONS

- From October 2019, pension trustees must update their schemes SIP to set up out their policies on ESG, climate change and stewardship activities.
- From 2020, additional requirements apply from 2020 to trust based DC schemes. Similar changes are anticipated for contract based schemes and their IGC's following an FCA consultation, expected in the first quarter of 2019.

EUROPEAN REGULATIONS

- New governance regulations came into force 13 January 2019 designed to implement the second European Pensions Directive (IORP II) with potentially further reaching implications in terms of integration of ESG into trustee risk control processes.
- Changes are also expected to flow from amendments to Shareholder Rights Directive, to be incorporated into national law by 10 June 2019.
- EC Action Plan on Sustainable Finance looks to bring new rules on ESG to all financial market participants.
- EU has indicated they will make TCFD mandatory if its not voluntarily adopted by 2023.

UN PRI

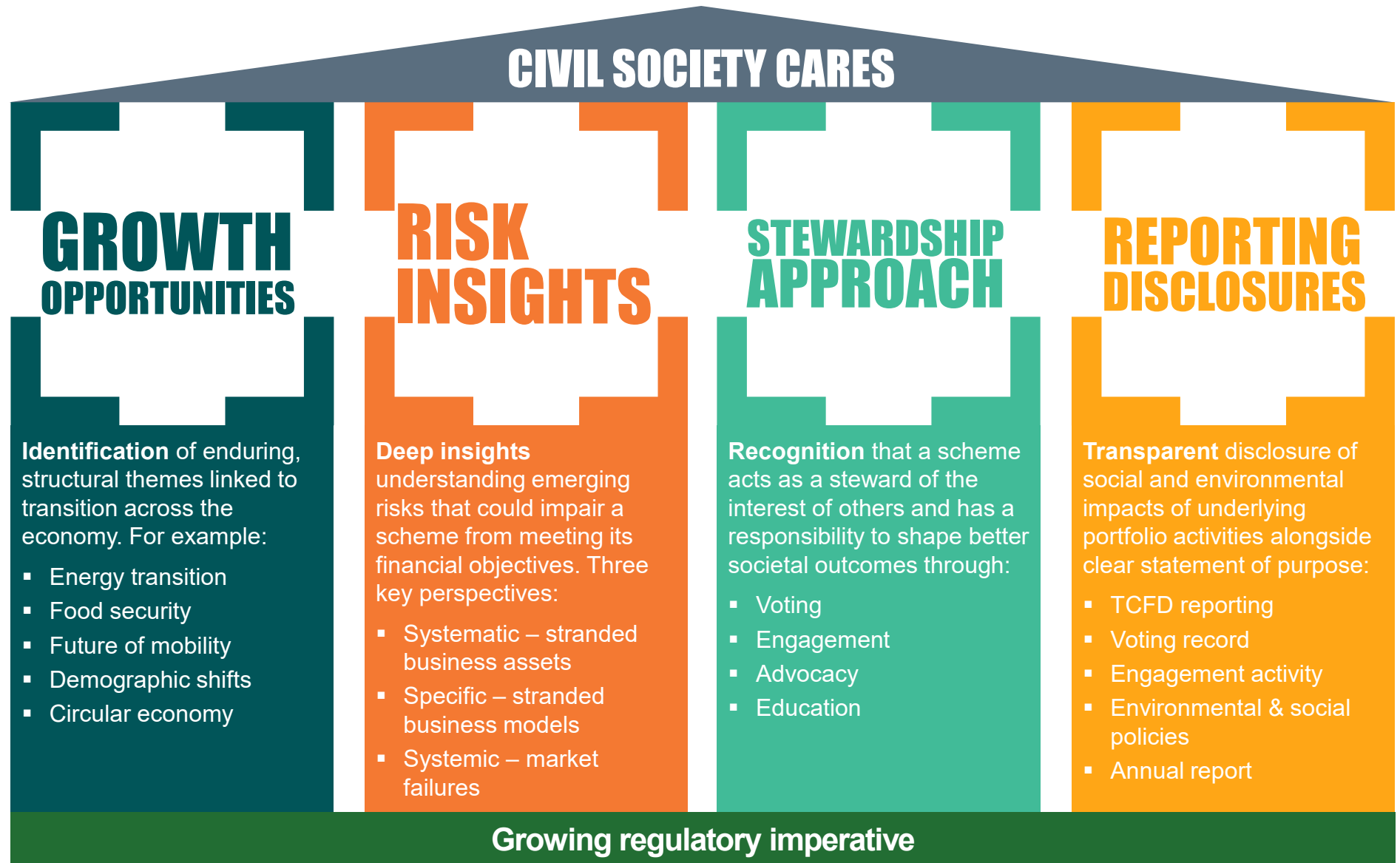
- TCFD-based reporting is to become mandatory for PRI signatories in 2020. While reporting will become mandatory, disclosure will be voluntary.

PRACTICAL STEPS FOR TRUSTEES

Context based

Four pillars of sustainable investment

A context based approach



Practical steps for trustee boards

Getting ahead of the curve

ESTABLISH CLEAR INVESTMENT PRINCIPLES

- Going beyond mere compliance
- Provide trustee training on ESG & systematic risks
- Annual review & scenario testing under TCFD

REVIEW EXISTING STRATEGY & MANAGERS

- Establish strategic opportunities versus funding status & resources
- Differentiate between active & passive approaches
- Approach to engagement & stewardship

MEMBER CONSIDERATIONS

- Identify appropriate strategy for DB & DC (where applicable) e.g. ESG as a default option
- Develop a clear communication strategy to members of ESG integration into investment principles

An integrated approach

An action plan for pension funds

Regulatory imperative

ACTIONS	COMPLIANT	VISIONARY
Establish a set of principles	<ul style="list-style-type: none"> Trustees receive training on ESG Establish responsible investment principles ESG a part of the risk assessment, including climate change 	<ul style="list-style-type: none"> Trustees undertake ongoing training/education to keep abreast of emerging ESG trends Identify clear sustainability goals
Assess competency of existing managers and consultant	<ul style="list-style-type: none"> ESG assessment a central part of manager selection Focus on how managers integrate ESG consideration into investment process over third-party labels 	<ul style="list-style-type: none"> All investment managers must demonstrate high levels of ESG integration and reporting Managers hold themselves to the same high standards as expected of investee companies
Set the role of sustainability in investment strategy	<ul style="list-style-type: none"> Establish the separate role of active and passive managers in achieving sustainability objectives Sustainability used as a lens to identify investable opportunities across asset categories 	<ul style="list-style-type: none"> Sustainable investment themes a central part of asset allocation approach – passive & active Clear alignment strategy alignment with delivery of a 2 C world or better
Document approach	<ul style="list-style-type: none"> Use the SIP to set out ESG priorities and sustainable investment focus Update SIP for new learning and regulatory change 	<ul style="list-style-type: none"> Detailed and structured policies on how ESG and sustainable themes are used to meet objectives Establish integrated approach to management of climate change and other systemic risk
Periodic review of managers	<ul style="list-style-type: none"> Encourage a high standard of reporting by managers to better compare and contrast across asset categories Increase standards for new managers 	<ul style="list-style-type: none"> Requirement for outcomes based reporting that details the environmental & social footprint of the portfolio Quantitative measurement of alignment with the Paris Accord
Establish role and extent of stewardship activities	<ul style="list-style-type: none"> Require managers to report on their voting record and engagement activities with companies Emphasise the importance of governance at managers Establish areas of systemic risk and consider exclusions 	<ul style="list-style-type: none"> Establish key engagement priorities and direct underlying managers on voting or engage directly with investee companies If resources are constrained, use a third-party proxy voting service
Climate scenario stress testing	<ul style="list-style-type: none"> Climate scenario as a formal part of the risk register Use of scenario tools to understand the potential risks in portfolios over multiple time horizons 	<ul style="list-style-type: none"> Detailed risk assessment across the entire portfolio to assess risk from stranded assets, as well as transition risks Exclude highest risk assets
Reporting to members	<ul style="list-style-type: none"> Includes information on policies, strategy and actions, including voting record, in annual report Establish plan for reporting under TCFD Recognise benefits of transparency for member engagement 	<ul style="list-style-type: none"> Produce a separate Responsible Investment report on an annual setting out key scheme level ESG metrics, voting & engagement record, statement of principles Adopt TCFD reporting

Conclusion

Not all schemes are equal, need to take a context based approach taking into consideration resources and situation, in the context of changing legal and regulatory requirements

Sustainable investing as an opportunity to take a fresh look at how we look at investment risk, asses growth opportunities and recognise our complex impact on the world around us

There are no easy answers and care needs to be taken to avoid ESG/Sustainability washing at the expense of delivering demonstrable change

First and foremost we have to be good investors – asset managers and owners alike – and sustainability should be a lens through which to view the world to make us better at our jobs

The complex, interconnected nature of the sustainability calls for a system-level approach that involves the way we invest and the manner with which we engage with our investments

Important information

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