**Summary**
• As regulation and attitudes change, pension trustees, sponsors and investment managers are expected to implement more responsible investment strategies.
• Although the landscape is changing, it may not be as simple as flicking a switch for responsible investing and the industry is presented with challenges on the road to improvement.
• Many understand that climate change and sustainability are long-term risks that cannot be ignored, and insist that education and collaboration can help the industry address the issues.

# Hurdling the barriers to responsible investment

**Although most pension schemes have increased their investments in climate-aware and sustainable funds, there is still a way to go to help meet the government's target of a net-zero economy by 2050. Jack Gray analyses the barriers facing schemes and how they can be overcome**

With no end in sight to the ongoing coronavirus pandemic, it would be understandable to worry that responsible investment would be put to the back of trustees', regulators', and investment managers' minds. However, excluding the first couple of months of lockdown, one of the very few silver linings from the pandemic is that it has increased discussions in this area as the world looks to grow back greener.

The government has recently been spearheading the initiative in the UK, closely followed by financial regulators, to help achieve its goal of net-zero carbon emissions by 2050. The response from the pensions industry has been mixed, with some stepping quickly up to the plate while others have been slower to react. However, those less passionate about driving improvements in sustainability have had their hand forced with recent regulatory and legislative changes around climate-risk disclosures and transparency.

**The hurdles**

Although most firms, schemes and individuals in the pensions industry want to evolve with the times, there are hurdles that need to be overcome in the pursuit of a more sustainable future. "The main barriers to climate-aware pension investing are problems surrounding measurement," begins Earth Capital chief investment officer, Gordon Power. "In recent years we've seen a concerted effort to converge around more standardised environment, social and governance (ESG) metrics, driven in part by the vast array of approaches used by different fund managers and rating agencies."

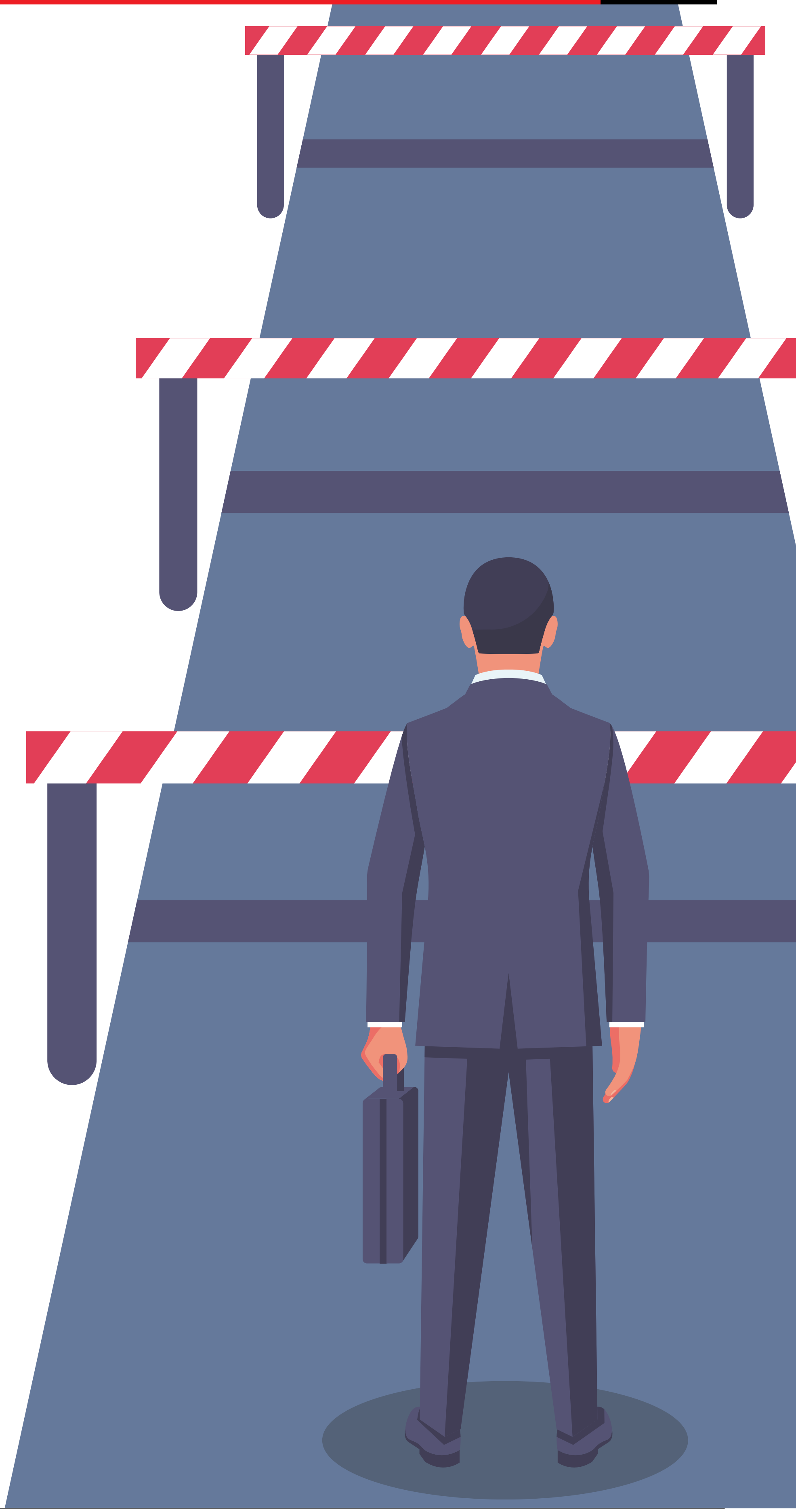
However, Power notes, even with more widely used metrics such as MSCI data, pension managers often interpret these metrics in different ways to produce their own ESG assessments. He warns that many measurement tools allow managers to overestimate their ESG performance and different managers' ESG ratings for particular investments can vary as a result.

"There are still issues around quality of data and how to interpret data," adds Nest responsible engagement manager, Katharina Lindmeier. While acknowledging that there has been significant growth in responsible investing, Lindmeier says there is still a risk that some in the industry see it as a "fad" and not the long-term risk that many others believe it to be.

LCP head of responsible investment, Claire Jones, agrees that there has been a "sea change" over the past two years, but warns there are still barriers in the form of inertia and slow decision making.

"It does take trustees time to become familiar with a new topic, make decisions and implement them," she continues. "There is also the practical problem that trustees have busy agendas, they have lots of things to consider, and typically only meet quarterly. We did see, particularly in Q2 this year, attention being focused elsewhere, quite understandably. Quite a number of schemes are dealing with more immediate issues, such as a sponsor that is struggling to fund the scheme, so that does inevitably make it harder to prioritise responsible investing."

Jones sees the availability of suitable funds as one of the larger issues preventing schemes from investing more responsibly. She notes that smaller schemes that need to access pooled funds, particularly defined contribution



schemes investing via platforms, are quite limited in the choices available and sometimes there is not a fund there that meets their requirements.

However, Aon UK head of responsible investment, Tim Manuel, disagrees: "In terms of finding investments that are more climate aware, I don't think there are that many barriers. There are a good range of options and opportunities for pension funds to move forward with what they are doing."

His colleague, Aon senior consultant: impact research lead, Oliver MacArthur, believes the perceived abundance of available funds is an obstacle in itself, as it can be "overawing" in terms of the scale of them. "Some of the barriers are knowing where to start. It comes back to trying to have a clear approach on what you want to do. Otherwise it can be a chaotic state to navigate," he explains.

"If you are a larger asset owner you have the privilege of being able to use segregated accounts where you can essentially choose any index you like. In the pooled fund world there is a more limited choice but there has been a lot of growth in pooled funds recently. There is no shortage of products to look at, which can pose more of a barrier."

**Navigating the hurdles**

Despite the hurdles facing schemes and investors, there are ways to overcome them. Experience and expertise can be crucial, for both trustees and advisers, with self-education and astute adviser selections a key driver for success in this area.

Jones notes that understanding responsible investing is about being able to see beneath the name of a fund, completing due diligence into investment managers' approaches, and getting comfortable with whether and how well the fund is integrating ESG considerations into its process. "As trustees become more experienced in talking to investment managers about this, they'll get better at seeing through the 'spin' into the substance of the funds," she says.

"Pension funds must embrace impact investing," urges Power. "Separate allocations to both private and public market strategies are fundamental to implementing a sustainable capital strategy."

Manuel states that regulatory requirements around climate-risk disclosure and transparency has been most effective in driving changes in behaviour on trustee boards. He adds that everyone needs to contribute to bring the collective policy across the industry to "a better place".

"It needs investment managers, investment consultants, company sponsors and trustees to play their part. Although others do influence them, it is really the trustees that set the tone and the direction and there is a need for leadership from trustees collectively."

Lindmeier believes that schemes have leverage and power in driving change, due to being empowered by members and assets, and can make "a lot of demands of fund managers" to help the industry progress.

**Collective engagement**

It seems clear that collective engagement is needed to drive progress, as such a huge global issue is unlikely to be resolved one group. "Climate change is dramatically impacting portfolios," stresses Power. "The entire pension sector – trustees, asset managers and members – must wake up to this reality if we are to see the dramatic change required to turn the tide on global warming."

Manuel believes individuals need to think about how they can have the most impact and prioritising that action, which, for many trustees, will be getting behind investment managers and consultants and encouraging them to do better.

"Collective engagement has a role," Jones adds, "probably with different parties acting at different levels of the system. There is also an important role at the investment manager level for collective action."

Furthermore, schemes, providers and employers embracing responsible investment can help improve members' engagement with their pensions overall. The issues sustainable investments seek to address can appeal to members on a human level and with high-profile campaigns, such as Make My Money Matter, increasing public awareness of the role their pension funds can play, it seems like an opportunity to drive member engagement.

"We've seen a number of schemes do it quite successfully, but a lot of trustees have not yet embraced responsible investing as a way of engaging their members," says Jones. "There is potential to do quite a lot, I think members care about the real-world issues that are encompassed in the ESG acronym. The challenge is that if trustees are at quite an early stage of developing their sustainable investment approach, they may not feel ready to expose that to members."

Lindmeier concludes: "Everyone can have an opinion on this and are things that affect a lot of our members in their everyday life. Working conditions and climate change, these are quite accessible to members and it is a really good way of trying to engage them with their pension.

"We believe strongly that, to uphold our fiduciary duty, we need to consider these issues."

**Written by Jack Gray**