Global Impact Forum

Impact trends and considerations for pension funds

This blog reflects views from our all-stakeholder **Global Impact Forum** event on impact philosophy, which highlighted the impact trends and considerations pension funds can take into account to achieve greater positive and lower negative impacts. hosted by **Charlotte O'Leary** and **David Brown**.

Sponsored by ***Aon***, ***Goldman Sachs Asset Management***, ***Nephila*** and ***Tikehau Capital***

“We are still missing a grand, unified theory of impact.”
INVESTMENT CONSULTANT

By Cameron Turner

WHY IS IMPACT IMPORTANT?

Taking impact into account has never been more important. The world is set to reach the 1.5°C level within the next two decades and only the most drastic cuts in carbon emissions from now will help prevent an environmental disaster. Rates of extinction have also been underestimated putting the global biodiversity ‘30x30’ targets – to protect and conserve at least 30% of world’s land and ocean by 2030 – under threat. Also, the UN estimates $3.5-4tn is needed annually to meet the sustainable development goals (SDGs) by 2030. A large amount of the funding must come from the private sector and the onus is on institutional investors.

TRENDS ACROSS DIFFERENT PENSION SCHEMES

Defined contribution (DC) schemes are receiving huge cashflows, which increases the investment budget available for governance activities. This, along with shifts to passive investing in public markets, makes room for new impact investment opportunities in private markets. DC schemes can and should deliver the impact narrative in their member communications to increase contributions and help avoid members’ pension poverty, thereby creating a virtuous cycle.

Local government pension schemes (LGPS), being open defined benefit (DB) schemes, are less worried about liability-driven investment (LDI) and, through the pooling system, can look at a wider universe of impact investment opportunities. It was also noted LGPS may be securing more impact investment compared to corporate schemes, due to their different stakeholder composition.

In private sector DB schemes, there are less opportunities due to their maturity. Given this, is there an alternative to buy-in or buy-out, where impact investment can be implemented? If not, DB funds should engage with their buy-in or buy-out provider on their approach to ESG and impact.

There is a lot of consolidation across the board, not just in DC. This is leading to greater assets under management, providing more impact investment solutions and greater weight in collaborative engagement efforts.

DOUBLE MATERIALITY

The advent of ‘double materiality’ in the regulatory sphere via the Corporate Sustainability Reporting Directive (CSRD) has shifted focus away from just financial materiality and ESG risks towards a more holistic view that also accounts for the impacts a company has on the world. Over time, we anticipate double materiality and impact will gain traction to become as ubiquitous as ESG.

IMPACT CONSIDERATIONS FOR PENSION SCHEMES

Green/impact-washing

Despite impact investment becoming more mainstream, the anti-greenwashing momentum built off the back of ESG has made it more difficult to get impact on the agenda, for pension funds and asset managers alike. It has created a strange situation where the people who are trying to make a difference attract more negative attention than those doing nothing. Despite this, impact-washing is still an issue to consider. Currently, only 20% of impact funds have contingency plans in case their impact objectives are not met. So, we must strike a balance between celebrating and encouraging impact and being aware of best practice.

Engagement, risk, return, impact and measurement

Looking to the future, impact integration should begin to take shape across entire portfolios, just as ESG has done. The entry point could be by reducing negative impacts through engagement across a pension fund’s portfolio.

At the other end of the spectrum, however, many see impact becoming the third pillar of investment alongside risk and return. Having said this, making the link between a company’s impact or an investment’s impact and an asset owner portfolio’s impact is still an issue.

It is easy to articulate for a single product, addressing certain impacts within a specific asset class, but for a pension fund investing across asset classes and impacts, how can they articulate or measure impact more generally? Perhaps this is where the monetisation of impact comes into play. However the industry develops, standardisation will be a key factor, not only for competition in the asset management industry but also for the ability to target impacts based on their scale.

Impact across asset classes and geographies

Impact investment can be achieved across both public and private markets, as long as capital is attributed to new or undersupplied capital markets, and stewardship and engagement is used effectively. There was a debate about whether to exclude China given its poor human rights record. We would discourage the use of exclusionary screens based on ESG criteria because if pension funds are to have positive contribution, they should use their voice as part-owners of assets.

Fiduciary duty

There is still confusion surrounding impact investing and fiduciary duty in the market. Many believe if you are investing with impact, you must be giving something up. But there are many opportunities to achieve market rate risk-adjusted returns while investing with impact. It was raised that we need to create more financially attractive impact opportunities to attract large-scale institutional capital. However, it is worth noting there is a question of whether it is reasonable, within the boundaries of fiduciary duty, to maximise returns at any cost, even if that means members retire into a world less liveable.

Follow the link to read the original event post this article relates to.

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