Impact Investing Principles for Pensions

Adopters' evidence 2022

By Mike Rogers

Since 2021 we have been delighted to welcome investment consulting and fiduciary management firms as Adopters of the Impact Investing Principles for Pensions. These firms play a pivotal role in the direction of pension fund capital.

Pensions for Purpose and the Impact Investing Institute believe adopting the Impact Investing Principles is an essential first step in helping to engage with industry and ultimately to encourage the deployment of capital to areas which have an environmental or social impact alongside a market rate of return.

The firms that have adopted the Principles are showing true leadership by setting an example to the industry. Crucially they are helping their clients to achieve better outcomes by improving their risk management and by identifying new opportunities that may otherwise be overlooked.

In the past, many might have seen investment as a competitive activity. This mindset sees investment as a zero-sum game with winners and losers taking a bigger or smaller slice of the pie. Impact investing is not like that – all investors benefit from a rising tide, and people and planet do better. Extending the technical language of investment, by acting together, we make beta bigger. Our Adopters have embraced this mindset and shown a true willingness to not only develop their impact consulting but to share their experience and their intellectual capital for all.

We are keen to acknowledge their contribution and to encourage others to adopt the Impact Investing Principles for Pensions.

KEY THEMES

We have set out some of the themes we identified by reviewing the evidence statements. These are grouped under the following headings:

- Investment consulting firm's own mission, governance and reporting.
- Helping clients to set their strategy.
- Supporting clients with implementation.
- Measuring outcomes.

Evidence statements

The Adopters all provided comprehensive evidence statements and the purpose of this document is to pick out key themes. We aim to highlight areas of leadership and point out gaps to be filled in or improved upon. We all recognise that this is the first year of adoption and the industry is on a journey. We expect to refine and define more as knowledge develops.

Public documents

Most respondents included links to existing public documents (for example, their UK Stewardship Code submission or annual responsible investment report). We encourage this approach as we believe it helps raise the level of knowledge and influence across the industry.

Our learnings and reflections

The first year of evidence gathering marks the start of the impact journey for the pensions industry. Historically, impact investing by pension funds has been the preserve of larger funds and has been somewhat piecemeal. Those consultants who have signed the Impact Investing Principles for Pensions are making impact investing accessible to all asset owners regardless of size or governance constraints. There is much still to be done though.

There are a confusing array of frameworks for ESG and impact investing, and the consultant Adopters are helping their clients to navigate their way through these. That said, definitions of impact remain unclear with different organisations, regulators and investors using different approaches.

It is interesting that some commentators seem to consider that impact can only be achieved in private markets. We challenge this view and would like to see impact considerations applied to all markets. Similarly, some investors set aside a specific part of a portfolio for impact. We support this and, at the same time, call for investors to go much further because every investment has impact. We believe that embedded in all economic activity is a complex mix of positive and negative impact. The evidence here suggests that the complexity of impact in all markets (public and private) is beginning to be understood. Furthermore, impact is not just a 'nice to have' it is central to the mission and structure of investment decision-making and this insight is feeding through to asset owners.

We look forward to next year's evidence statements and to seeing this area develop further.

WEBLINK
Find out more about the Principles

Statements from our Adopters

Hear from some of our Adopters, in their own words, about why they decided to adopt the Principles for Pensions framework

"As a fiduciary manager, the way we direct capital not only shapes the financial returns we can deliver for our pension scheme clients and their members but also the impact we have on the world. The way we invest is changing, driven by a fundamental shift in how companies are being viewed and valued. Where once we considered only risk and return, we now assess a third dimension – impact. We believe that considering these three pillars together can help us assess an asset's real value and make better investment decisions for our clients. This is why we fully endorse the Impact Investing Principles for Pensions."

SCHRODERS SOLUTIONS

"We support the Impact Investing Principles for Pensions and commit to:

1) Seek investment advice on an impact investing approach for our pension fund.
2) Review ESG impacts across our investment portfolio.
3) Consider available investment strategies.

We will be able to demonstrate action in or several of these areas within six months of adopting the Principles and will recommit on an annual basis with evidence on how the Principles have been used."

CARDANO

"Responsible investing is core to our advice to clients as we believe it forms the basis of good investiment decision making. Going further however, pension scheme trustees are increasingly looking to pursue positive impact while generating financial returns. Investing with the intention to contribute towards alleviating global social and environmental challenges is key to a future that members can retire into and we are keen to support pensions schemes on this journey. We endorse and welcom the Impact Investing Principles for Pensions which set out a much-needed framework with practical steps in the evolving area of impact investing."

XPS INVESTMENT

"There is a shift in the way investors are approaching responsible investing. ESG integration is fast becoming a norm; investors are increasingly wanting to go beyond and invest with impact. Asset owners wanting to allocate to impact funds face some distinct challenges from education on 'what impact they can have' to weeding out the impact washing that is highly prevalent.

At bfinance, we've been working closely with a range of institutional clients to address these challenges, including navigating their entry to the rapidly evolving product universes and expect investor demand to continue to grow in the coming years. The Impact Investing Principles, which we endorse, brings practicality to helping pensions schemes allocate their capital with people, planet and profit in mind."

BFINANCE

Adopters of
Impact Investing Principles for Pensions

Thanks for the leadership provided by our Adopters.

AON | Barnett Waddingham | bfinance | cardano | Gordian Advice | isio. | Redington | Schroders solutions | Van Lanschot Kempen | XPS Investment

1 Firms' mission, governance & reporting

This section describes the way the investment consulting firms have aligned their businesses with impact investing

Mission and culture

A number of respondents explained how they had worked to integrate impact within their firm's overall mission and culture. For example, one organisation had updated its mission statement to explicitly include 'People and Planet'.

This was often accompanied by information on industry memberships as an indication of the level of institutional commitment to integration of ESG and impact considerations.

Governance

Successfully incorporating impact needs strong firm-level governance. Respondents included commentary on the following elements of their governance.

Organisational structure – respondents typically had specific committees for impact oversight. The best respondents had clear accountability directly to the Board or included key Board members such as the CEO and CIO of the business. The committee would generally have a direct influence over business functions such as manager research, consulting and strategy. This meant the committee had teeth – for example, setting clear parameters for manager research and objectives for delivery - and it was held to account by the Board.

Setting policies and beliefs – most respondents had beliefs statements and help clients to develop their views in this area. Interestingly one organisation described these as 'principles and preferences' – principles to guide all clients and preferences that were applied in the absence of a strong client view.

Resourcing – most respondents provided quantitative data around the number of researchers involved in impact investing. We wonder whether this could be extended to include the proportion of research budget or amount of P&L re-invested into the business to develop impact investing.

Organic growth vs acquisition – investment consultants have typically grown their expertise organically by hiring individual specialists. A small number had acquired specialist boutiques to fast-track their work. We wonder if this trend will continue and whether we will see the growth in importance of boutique impact consulting firms.

Training staff – some respondents outlined the training programmes provided to their associates. For example, the CFA Certificate in ESG Investing or the Institute and Faculty of Actuaries' climate change course. We would like to see organisations encouraging such training and collecting management information on this, outlining the proportion of client facing or research staff that have ESG qualifications.

Incentives – there was relatively little information on the way various business units were incentivised to include impact in their research or advice. For example, is impact included within the objectives for all consultants delivering client advice? Is impact included for all manager researchers? If it is included, what weighting is it given?

Reporting and review

An important part of successful governance is monitoring and reviewing progress. Several respondents were able to give detailed management reporting on their progress. For example, they know what proportion of staff had been trained, the proportion of clients receiving training, surveys, setting beliefs and the proportion of assets invested with impact considerations. We would like to see more evidence of this as the Principles develop. The very best governance structures would set targets for each activity and show progress against targets.

2 Supporting clients to set their strategy

This section describes how Adopters have helped their clients to set their own mission, governance and impact strategy

Defining impact

Investment consultants have a significant role in assisting their clients by defining impact investing, and helping them to develop their investment philosophy and beliefs in this area so impact considerations can be applied across entire portfolios.

Many of the responses included ESG integration together with impact, which is understandable as the two are closely interlinked and there are numerous overlapping frameworks. For next year's evidence statements we will ask Adopters to describe how they articulate the spectrum from ESG integration through to impact.

Strategy

Many respondents described a step-by-step framework used to deliver advice to their clients. This typically included:

- Initial training or discovery step where clients were trained on specific topics or surveyed.
- Advice on beliefs, policies and strategy.
- Action - for example implementing specific investment mandates,
- Monitoring - for example, monitoring investment manager engagement and ESG metrics

Data on the proportion of clients receiving ESG advice was sparse. The best responses in this area included details of the proportions of clients taken through each step of the consulting framework and one respondent went so far as to make this information available publicly.

Beliefs surveys

A common approach is the use of beliefs surveys to understand client's views on ESG and impact. An area to develop is the linkage between education and surveys, which was not addressed in the responses. A crucial role for investment consultants is to articulate the regulatory background, for example, the role of fiduciary duty and distinguishing between financially material factors and non-financial factors. If clients are unaware they should incorporate financially material ESG factors, the results of any survey may be skewed.

ESG across the entire portfolio

ESG is often considered at strategic level but then implemented through perhaps just one specialist mandate. We would like to see this evolve into a whole-portfolio philosophy where impact is considered throughout, recognising that different parts of the portfolio will have different impact emphases. We appreciate there are significant challenges in implementing and measuring impact across the entire portfolio.

Setting governance, beliefs & strategy

Through education, advice and engagement, investment consultants are seeing clients refine their investment strategies to incorporate impact. It is clear from the responses that we are at an early stage in this process and, although there are examples of this following through to implementation, there is more to be done. A common description was "clients are on a journey".

Next year we would like to encourage Adopters to monitor where their clients have reached on their journey and the extent to which they have implemented their strategy.

Contribution to industry forums, collective engagement and media influence

By representing client views, investment consultants can give a voice to those clients that might not otherwise be heard. It was therefore encouraging that many Adopters described how they provided a conduit for collective engagement, for example by hosting client events with impact organisations, government or regulators. The Investment Consultants Sustainability Working Group (ICSWG) was also cited as a forum for sharing and developing ideas.

3 Supporting clients with implementation

This section describes the way investment consultants have helped clients implement their impact strategies, by developing impact frameworks and finding investment managers who are aligned with these frameworks

Impact models

Leaders in this area had developed some proprietary frameworks such as models of influence. We would encourage investment consultants to develop this area further as impact is not widely understood and tends to be split in a binary way into 'good' and 'bad', failing to recognise that a single entity might have both positive and negative impact. We are also conscious that there are a bewildering array of frameworks and believe that investment consultants have a significant role to play in helping their clients navigate through them.

Climate-change leads the way

The vast majority of examples and data provided related to climate-change. This is understandable given both the urgency of the issue and the new regulatory and disclosure framework. Even within this area, there is clearly much more to be done. Adopters had typically invested in climate scenario analysis, either by developing in-house tools or buying-in external expertise.

How advice is delivered

Most Adopters appear to deliver advice through a combination of specific projects, strategy reviews, annual reporting and quarterly reporting. Annual reporting might be at firm-level – for example, an annual responsible investment (RI) report which sets out the firm's approach – or it may be client-specific, including analysis of the portfolio held by that client. Several organisations provide detailed quarterly reports with portfolio specific ESG data and climate data. In one case, all clients receive such a report. We would like to encourage Adopters to ensure that data is purpose driven and actionable. Clients need to be clear why a particular metric is included; how it is expected to change, ranges and anticipated action if the metric moves out of its range.

Manager research – engagement not exclusion

A key role for investment consultants is researching investment managers and mandates to find those that fit with their client's objectives.

Respondents typically described clear processes for reviewing investment managers. Generally, respondents required their asset managers to have a minimum level of ESG integration and engaged with laggards to improve this. Some respondents set out detailed engagement processes; for example, setting a fixed period of time after which investment managers would be removed from buy lists if engagement failed to result in improvements. No examples were given of investment managers having been removed from buy lists as a result of this process, which may represent a success (because engagement works) or a failure.

We encourage Adopters to provide more information around their manager engagement processes. For example, some respondents did set out the proportions of managers falling below the level required together with progression over time. Others provided examples of engagement resulting in improved ESG integration.

It is notable that engagement focused around ESG integration. There was less clarity around the process for, and success in, engaging to develop impact mandates (although several respondents provided examples). A potential theme to explore next year is how to successfully engage with managers for change and the role that collective engagement might play in this.

Client examples

A number of respondents gave detailed examples of clients that had developed and changed their approach to impact investing. Drivers for change included regulatory guidance, development of best practices and highly motivated pension plan sponsors (for example, where a sponsor had a strong view on impact due to its charitable objectives or environmental background).

Typical outcomes included updated governance (for example, updated investment beliefs and policies), allocations to impact investments and improved reporting. Impact investments typically focused on renewables, climate solutions and social housing. Importantly, one outcome was an allocation to impact within the default allocation for a DC master trust.

4 Measuring outcomes

This section outlines the progress and challenges associated with measurement. This covers two main areas – measurement of the level of adoption of impact investing and also the way that clients measure impact outcomes at portfolio level

Examples of setting impact objectives and interim targets – mandate level

All respondents provided excellent examples of areas of setting objectives and targets for specific investments. The United Nations Principles for Responsible Investment (UNPRI) sustainable development goals (SDGs) were often cited as a starting point for objectives and some organisations are investing in tools to map investments to SDGs. In one case, client reporting showed the proportion of the strategy contributing to each SDG.

An area for development is the expansion of objectives and targets to include the entire portfolio, not just a specific 'impact' mandate.

Increasing use of external data providers or development of in-house tools

Respondents all cited data as a challenge. The industry seems to be developing and moving on from relying on data from investment managers. Some respondents had recently appointed independent data providers and others were developing proprietary tools.

The use of external data providers involves an explicit cost to the investment consultant and demonstrates a commitment to developing this area. Reasons given for using external data providers (rather than relying on a manager's data) included challenge and validation of investment manager's data, to identify companies for engagement and to ensure this was followed through.

A few Adopters were developing proprietary tools which perhaps represents a further evolution – reducing the risk of 'group think' in impact measurement but potentially creating a wide range of different approaches.

Measurement of take-up

There is much more work to do on the way we measure take-up of impact investing. Some organisations found it difficult to measure and did not provide data. The best data tended to be expressed as a proportion of overall numbers of clients or proportion of assets under management. There were also problems over the definition of impact. We would like Adopters' feedback on how this aspect might be improved – ultimately, we are aiming for a position where we can see evidence of take-up increasing year-on-year.

Improvements in reporting

Most organisations produce an annual responsible investing report which sets out the firm's approach. In the past, critics argued that RI reports were too selective and were anecdotal: a more 'forensic' approach was needed. We found that the leaders in this area adopted a highly analytical approach to reporting. For example, linking description of their mission, governance and strategy to outcomes and client and investee level. They also provided year-on-year comparables to demonstrate progress.

Feedback from Adopters

How would you like the Principles to evolve?
Are there any refinements needed to the Principles? If so, what do you suggest?

How would you like evidence gathering to develop?
Do you like the open-ended approach or would you like us to ask specific questions (for example, list out your memberships of relevant industry organisations).

How can we improve data gathering?
We believe that the most powerful evidence is, ultimately, the rate of adoption by clients. There seem, however, to be challenges in collating this information. What suggestions do you have for collating this information; how can Pensions for Purpose and the Impact Investing Institute help?

Would you like your organisation to be explicitly recognised for particular areas of excellence?
Certain aspects of Adopters' responses showed creativity and thought leadership. How would you like to be acknowledged? For example, through awards or through invitations to speak at events?

Your feedback

"We want to work closely with the Adopters to bring out the best in the industry. We will therefore seek feedback from Adopters and others on how we should evolve the process next year. Answer our questions..."

Pensions for Purpose

Pensions for Purpose already offer access to general information and education through our membership and forums. We also run tailored events for individual pension funds.

Join us

If you would be interested in joining Pensions for Purpose, please contact Stephen Darlington, our Membership Manager (use the 'get in touch' button below).

- ***Mike Rogers is an Investment Professional and qualified Actuary.***

Please get in touch with your ideas or to join Pensions for Purpose

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