

Is regulation enough?

A review of UK master trusts' ESG policies

ShareAction»

Author

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About ShareAction

ShareAction is a UK registered charity working globally to lay the tracks for responsible investment across the investment system. Their vision is a world where ordinary savers and institutional investors work together to ensure our communities and environment are safe and sustainable for all.

In particular, ShareAction encourages institutional investors to be active owners and responsible providers of financial capital to investee companies, while engaging meaningfully with the individual savers whose money they manage. Since 2005, ShareAction has ranked the largest UK asset owners and asset managers on their responsible investment performance.

ShareAction works with players across the investment chain to create a movement for responsible investment. This movement includes savers who all too often feel excluded from the investment system, to the institutional investors that operate within it and the policy-makers that regulate it.

Acknowledgements

We gratefully acknowledge the financial support of the Ashden Trust, JJ Charitable Trust, and Mark Leonard Trust for this project. We would also like to thank everybody we consulted throughout the research process.

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Executive Summary

This report is part of a multi-year project into corporate pension schemes' approach to climate change risk and sits alongside direct engagement with schemes to raise awareness and standards across the industry.

For this report, 16 of the largest master trusts by assets under management (AUM) were reviewed. The report focuses purely on the work of the trustees of the master trust, not their sponsoring group/asset manager/investment consultant. We have used The Pensions Regulator's definition¹ of a master trust, which is an occupational pension scheme that provides money purchase benefits and is used, or intended to be used, by two or more employers.

In early 2019, ShareAction published a report on corporate pension schemes' policies and practices in relation to climate change, [Will Employees Benefit? Protecting Corporate Pensions Against Climate Change](#). The report found wide variance in corporate pension schemes' integration of climate-related risks. In addition, ShareAction discovered many corporate pension schemes were using master trusts. The move towards master trusts, away from employer trust schemes, means that a significant number of employees are, and will be, automatically enrolled into these trusts. We expect to see master trusts' role dominate the pensions sector in future. This means that their approach to environmental risks such as climate change is important. Not only will they be responsible for the pension outcomes of millions of ordinary people, they will also start to play an increasingly important role in how pension assets are allocated and investments managed. Our auto-enrolment report in 2018, [The Engagement Deficit](#) found that only one out of the 12 auto-enrolment providers on the market offered a default fund that incorporated climate risk into its asset allocation.

This review sets out how Environmental, Social, Governance (ESG) and climate risks are being addressed by master trusts serving the defined contribution auto-enrolment market, in light of recent policy developments in the UK

What is responsible investment?

Responsible investment (RI) is an approach to investment, which takes into account environmental, social, and governance (ESG) risks. It is characterised not only by addressing these risks in investment strategy, but also by activities such as actively engaging with investee companies on their ESG practices and seeking to steward them over the long-term.

Findings

Our findings are mixed. Asset owners are acknowledging that their investments have a broader impact on their beneficiaries' lives. However, there is also a lack of oversight and attention to stewardship, which undermines the attention being given to impact.

1. Low-scoring master trusts are over-reliant on other market players (their sponsoring group/asset manager/investment consultant) for direction on responsible investment issues
2. Master trusts are largely over-delegating stewardship to their asset manager without sufficient oversight
3. Master trusts show low levels of engagement with policy makers on the low-carbon transition
4. There has been an increase in take up of ESG/ climate funds into master trusts' default asset allocation
5. High scoring master trusts show signs of acknowledging the impact of investments on society and the environment

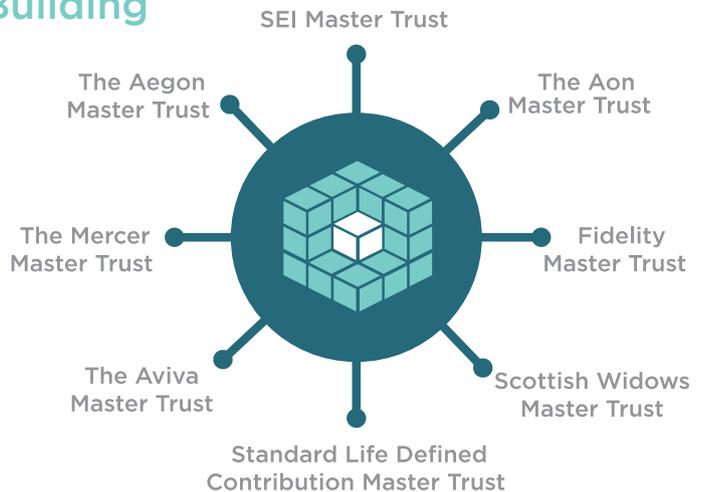
Following the review, master trusts were grouped into four groups to demonstrate their position in their RI journey relative to their peers. The results are below and definitions of each group can be found later in the report.

Results

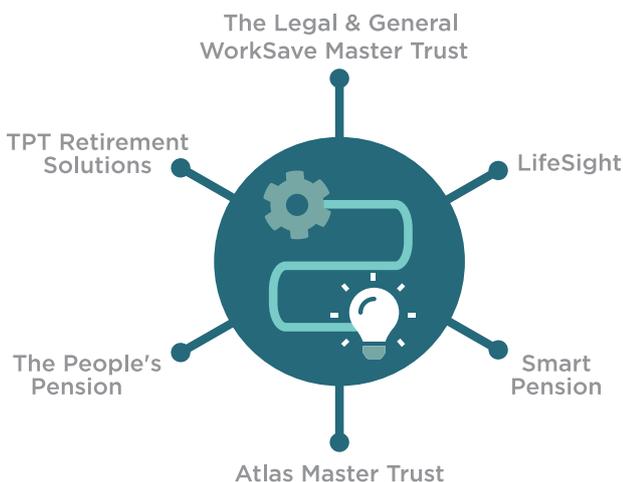
Learning



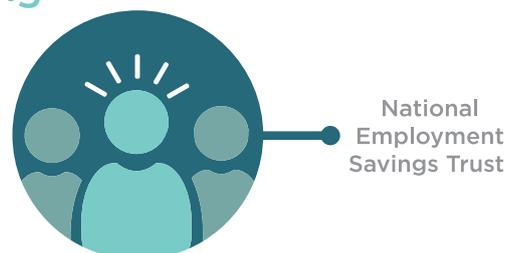
Building



Implementing



Leading



Recommendations

We set out what we would expect master trusts to do in order to score in a higher group.

Learners

- Master trusts should consider an allocation to ESG funds
- Master trusts need to have a clear voting policy on ESG which they communicate to their asset manager
- Master trusts should consider more innovative member engagement strategies for example narratives on RI issues
- Trustees should continue to educate themselves on ESG issues and climate change as the field evolves and develops

Building/Implementing

- Master trusts that have incorporated ESG allocation into their default fund should extend the ESG allocation to all of their equities and consider how to incorporate ESG into other asset classes.
- Master trusts should reduce exposure to the fossil fuel industry and engage robustly with remaining holdings with a clear procedure for escalation, including divestment, where engagement is not working
- Master trusts should engage with their asset managers on the impact of their investments on issues such as biodiversity and human rights
- Master trusts should consider using Red Line Votingⁱⁱ
- Master trusts should collaborate on RI initiatives and join investor coalitions to signal to governments and companies the financial risks of not acting on climate
- Master trusts should have mechanisms for better understanding members' views on how their money is invested and stewarded and consider incorporating member views into stewardship activities
- Master trusts should report under the Task Force on Climate-related Financial Disclosures (TCFD) and encourage their asset managers to do the same

Implementing/Leaders

- Master trusts should consider segregated accounts in order to have control over voting
- Master trusts should consider investing in private markets, infrastructure and social impact to diversify portfolios and maximise allocation to low-carbon opportunities
- Master trusts should consider incorporating ESG into other asset classes such as fixed income

Introduction

On Friday 20 September 2019, millions of people joined school strikers to demand more action from governments on climate change. More protests followed in October from Extinction Rebellion in reaction to the world's ever-increasing extreme weather events and turmoil. These protests represent changing public perception of the risks of climate change and its impact. Against this backdrop, Guy Opperman, the Pensions Minister, has said, "Pension funds are a powerful weapon in the fight against climate change. Despite some good work by a number of schemes, some are not acting. We need urgency on this vital issue from trustees and investment managersⁱⁱⁱ".

The purpose of the review is to rank master trusts on their ESG policies, to demonstrate how seriously master trusts are taking ESG and climate change in their investment activities. The law now requires them to have a policy on how ESG risks and opportunities (and specifically climate change) are incorporated. 2019 saw the publication of illuminating research on both the impact of climate change and savers' views on the matter. The global investment firm Franklin Templeton published a report that concluded that "45 per cent of people would be willing to make additional contributions if RI was incorporated into their pension^{iv}". The Department for International Development (DFID) also published research on the UK public's view of RI and found, "when presented with a choice, most people in the UK would prefer their investments to consider impact on people and the planet, alongside financial considerations^v". Lastly, a report from the Cambridge Institute for Sustainability Leadership, on whether environmental and social information impacted decision making found that "public interest in sustainability does influence investment preferences when suitable information is provided^{vi}".

It is now widely accepted, by the investment industry and regulators, that climate change is relevant to financial due diligence. However, action in this area has been slow and fragmented, with different regulators taking different approaches. Furthermore, many financial indices still contain a large percentage of oil and gas and mining stocks and there is poor disclosure from companies on some environmental, social and governance (ESG) factors. Even those within the financial industry taking climate change seriously, appear to view it predominantly in terms of how it poses risks to, and opportunities for, maximising their investment returns. Whilst this is an important lens, the industry is yet to look at how it understands and contributes to the impact its investments have on the wider world in which their beneficiaries live and into which they will retire. By framing the problem of climate purely in risk terms and not considering impact, market participants focus their efforts on resilience, instead of working on mitigation. The greatest financial risks, will come from not meeting the goals of the Paris Agreement and the macroeconomic impact associated with this.

The decisions on how assets are allocated and how investments are stewarded have a real-world impact. In respect of climate change, they help to determine factors such as the financing of low-carbon energy alternatives or whether fossil fuel companies have business models aligned with a sub-two degree world. We would argue that fiduciary duty in a wider sense means taking responsibility for understanding and accounting for the impact of investments on beneficiaries' quality of life. After all, good financial returns will be worth nothing on an uninhabitable planet.

Regulatory landscape

The main source of information for this review was the largest 16 master trusts' new ESG policies contained in their Statement of Investment Principles (SIPs) made compulsory by new investment regulations. The policies provided comparable information to review schemes.

Specifically, from 1 October 2019 the vast majority of trust-based pension schemes are now required to have a policy in relation to:

- How trustees consider financially material considerations in investing. These include financially material environmental, social and governance considerations (including climate change, which is explicitly specified in the regulations)
- The extent (if at all) to which trustees consider, in investing, the views of the members and beneficiaries including (but not limited to) their ethical views and their views in relation to the social and environmental impact and present and future quality of life
- Stewardship activities, including voting and engagement, across the scheme's investments. This includes issues such as social and environmental impact and corporate governance

Methodology

ShareAction's [auto-enrolment](#) survey looked at the biggest auto-enrolment providers in the UK market, both trust-based and contract-based. For this review, we focus on trust-based schemes only. This is because the changes in regulation only apply to trust-based schemes. While in early 2019, the FCA consulted on whether it should apply similar rules to the contract-schemes within its supervisory remit, its decision has not yet been announced. This review is therefore an important exercise in understanding how the regulatory intervention has impacted on the quality of schemes' policies.

All master trusts chosen have been authorised by The Pensions Regulator. Using research by Corporate Adviser^{vii} master trusts were chosen for this review based on size of AUM. The largest 16 master trusts were selected. Blue Sky Pension was replaced with Smart Pension as the schemes had similar AUM but Smart Pension has significantly more members. We acknowledge that AUM varies significantly between master trusts, as does number of members. We felt that the largest 16 master trusts covered a significant section of the market.

Master trusts are also significant in the workplace pension market. Of the master trusts selected in total, they have in excess of 15 million members and over £34 billion worth of assets. With assets doubling since 2010^{viii} and the trend set to continue, master trusts are significant players in the pensions industry with the resource and influence required to give their RI policies real meaning.

All master trusts in the review were informed of the research in advance and asked to confirm that all of their publicly available documents containing information on RI were up to date. The focus of the review was schemes' newly updated SIPs, which must now contain ESG policies. Other documents were also reviewed, including standalone RI policies, chair's statements and annual reports. The focus was publicly available documents but schemes were also given the opportunity to provide further information concerning RI in their scheme's default funds even if this is not public. Overall, ShareAction advocates for transparency by schemes because of the wider public interest in how large institutional investors manage money and the value in public information to helping schemes compare their performance on RI with their peers, thus driving up standards. Therefore, relevant non-public information was scored half points. This was to ensure that schemes were rewarded fairly for having policies etc. in place, but to reward more fully the schemes who were also transparent about their activities

Review design

The review contained 26 questions split into four categories: Governance, Strategy, Risk Management and Disclosure. This broadly follows the TCFD framework and maps across to ShareAction’s global surveys such as [Pensions in a Changing Climate ranking](#). The review looked specifically at the following topics: investment beliefs, default fund design, stewardship and member engagement.

Following the review, master trusts were grouped into four groups to demonstrate their position in their RI journey relative to their peers. The groups are defined loosely below; however, a scheme could show attributes from groups below and above them.

Learning group



A typical “learning scheme” has taken some steps to understand RI and think about their investment beliefs but is delegating the majority of responsible investment activity to either their asset manager(s) or corporate group, within which the master trust sits.

Building group



A typical “building scheme” has demonstrated more serious consideration of their investment beliefs and may have even altered their asset allocation to incorporate an ESG tilt. They may also be considering how to engage with their membership on RI.

Implementing group



A typical “implementing scheme” has shown ownership over their RI activity through their asset allocation and stewardship activities and is thinking more holistically about the impact of their investments on their scheme membership. They may also be actively trying to engage with their membership on RI.

Leading group



A “leading scheme” has not only changed their asset allocation to incorporate ESG but is very active on stewardship showing the outcomes and impact of their stewardship and being a vocal and active member in RI initiatives. They are also actively trying to engage with their membership on RI.

Findings

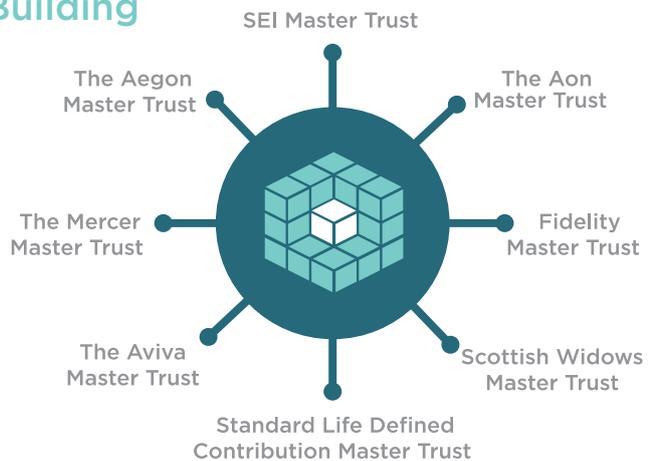
There has clearly been a lot of education and learning through the introduction of legislation requiring master trusts to have a more detailed ESG policy. This seems to have brought responsible investment to the forefront of trustees' minds within the master trust sector. This is a positive development because ShareAction's leading practice research^{ix} reveals that the mere process of formulating a formal policy on responsible investment topics such as climate change can help galvanise internal support by executives/management within an asset owner and drive stronger implementation. The findings from the report are mixed, with master trusts scores varying significantly. Overall policies have improved and some action has been taken but action on stewardship remains low.

Results

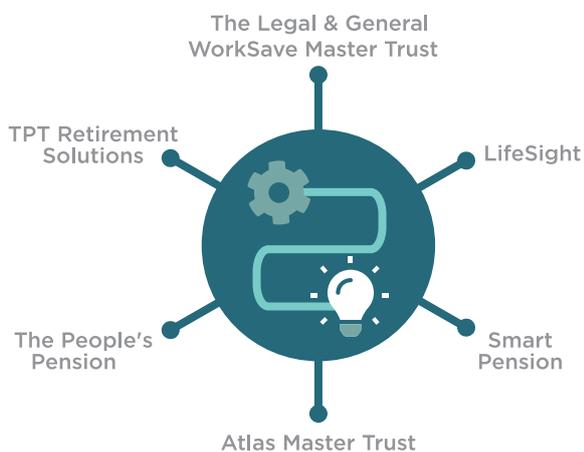
Learning



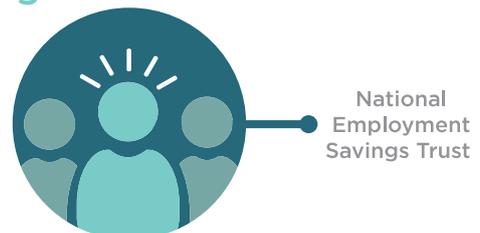
Building



Implementing



Leading



Key findings from our review of master trusts are as follows:

1. Low-scoring master trusts are over-reliant on other market players (their sponsoring group/asset manager/investment consultant) for direction on responsible investment issues
2. Master trusts are largely over-delegating stewardship to their asset manager without sufficient oversight
3. Master trusts show low levels of engagement with policy makers on the low-carbon transition
4. There has been an increase in take up of ESG/climate funds into master trusts' default asset allocation
5. High scoring master trusts show signs of acknowledging the impact of investments on society and the environment

Finding 1

Low-scoring master trusts are over-reliant on other market players (their sponsoring group/asset manager/investment consultant) for direction on responsible investment issues

A key factor separating those in the implementing/leading groups with those in the building and learning groups is independence. It appears that master trusts, which are run by an asset manager, consultant or insurance company, are referencing the RI policies and practices of the wider corporate group as opposed to having ones specific to the trustee board. Without a clear mandate from the trustees, it is hard to see how this would result in best practice RI activity for the master trust and bold action on climate. Whilst corporate group practices might be of a good standard, the aim of the new regulations is to ensure trustees are undertaking a thorough process of considering how ESG and climate are embedded in their investment processes. If trustees are simply referring to other agents' policies, it suggests they are not undertaking this process and a potential result is that RI is not driven through the investment chain. Examples of this over-reliance are below:

- *“The Trustees ascertain from pension provider how ESG factors are taken into account when pension provider selects and governs fund managers.”*
- *“The Trustees have delegated day to day management of the assets to the Delegated Investment Manager who in turn delegates responsibility for the investment of the assets to a range of underlying investment managers”.*

Some master trust trustees are therefore in essence acting like Independent Governance Committees, simply reviewing actions taken by others rather than taking responsibility for the assets they hold on behalf of beneficiaries. We would recommend that master trusts take ownership of their RI policies in the next stage of the regulations and demonstrate the actions they have taken in their implementation reports.

Finding 2:

Master trusts are largely over-delegating stewardship to their asset manager without sufficient oversight

The significant factor separating schemes in the review is stewardship. To score highly master trusts had to show they were at least engaging with their asset manager on stewardship and receiving reporting from their asset manager on engagement activities. Only **Nest** showed much activity beyond this. The majority of master trusts are delegating stewardship to their asset managers and lack stewardship policies on climate change.

Nest's score in the leading category is a reflection of their stewardship policy and activities. **Nest** have their own voting policy with which to engage their asset managers and are transparent about their engagement with companies and the outcomes it has. By contrast, the majority of master trusts reviewed are delegating the responsibility of voting and stewardship activity to their asset managers and to the company group level, as can be seen in the examples below:

- *“Therefore, the Trustees look to pension provider to consider, as part of its wider due-diligence process, how the passive equity manager positively engages with companies where there is scope to improve the way ESG factors are taken into account when running a company.”*

- “The Trustees delegate to pension provider the responsibility for the stewardship activities that apply to the Trust’s investments.”
- “Where assets are actively managed, the Trustees looks to the insurer to consider how the investment process for active managers takes ESG into account in the selection, retention and realisation of investments where possible in addition to how the manager positively engages with companies where there is scope to improve the way ESG factors are taken into account when running a company.”

This level of delegation points to a breakdown in responsibility. Stewardship of ESG factors is a crucial pillar of responsible investment. Furthermore, voting at AGMs is an important mechanism by which to influence corporate management and without direction from asset owners, asset managers are free to vote without a mandate. Delegating to pension providers makes the chain from the trustees to the asset managers even longer and accountability between client and agent becomes blurred. Master trusts should be independent from their sponsoring insurers, consultants and asset managers and should have stewardship and voting policies that set out clearly their expectations on climate change and other ESG factors.

As master trusts grow in size, we would like to see an informed dialogue between asset managers and master trusts about stewardship. In relation to voting, best practice is for the larger schemes to have segregated accounts. Segregated accounts would allow asset owners to influence voting decisions directly in accordance with their own RI policies. In May 2019, the Association of Member Nominated Trustees (AMNT) conducted a review^x into fund managers’ voting policies and practices. This review followed their publication of Red Line Voting. Red Line Voting is a new approach to voting in order to enable far greater direction from institutional investors on environmental, social and corporate governance issues. The review found that as pension schemes began to adopt Red Line Voting, fund managers refused to accept them with regard to holdings in pooled funds. The AMNT explains that since pooled funds represent almost half the AUM, refusal by the asset management industry to implement asset owners’ voting policies puts pension schemes in a very difficult position.

While being in a pooled fund currently provides a practical barrier to voting it should not provide a barrier to engagement. ShareAction’s recent proxy voting report, [Voting Matters: Are asset managers using their proxy votes for climate action?](#), points to a number of key votes at companies which are obstructing climate progress. Asset owners are often resource constrained and key votes are an efficient way of engaging their asset manager, as exemplified in our report.

In this review, the **People’s Pension** talk about the need for an escalation strategy if engagement is not working. ShareAction consider this a key aspect of any engagement, this is particularly important in relation to climate change given the urgency of the risks it poses to the financial sector and environment. Engagement without boundaries or ‘teeth’ is unlikely to result in change at the pace required. Having a clear escalation strategy, potentially including divestment, gives investors and companies a clear sense of the risks of inaction. A key finding of ShareAction’s best practice survey^{xi}, which interviewed leading asset owners on their climate strategies, found a number were trying to escalate their engagement activities to have more impact. Asset owners should produce escalation strategies for when engagement with companies, within a pre-determined timeframe is not successful. This strategy should then be clearly communicated to asset managers.

The **People’s Pension** escalation strategy is below:

“In the case of failed engagement with companies, further action may be required such as voting against current board members, reducing the amount invested, negotiating a change to the dividend, or removing them from the portfolio entirely.”

Stewardship Code

The 2020 Stewardship Code, recently published by the Financial Reporting Council (FRC), has introduced substantial reforms to the previous 2012 iteration. The new Code is placing more stringent expectations on signatory. It defines stewardship as the “responsible allocation, management and oversight of capital to create long-term value for clients and beneficiaries leading to sustainable benefits for the economy, the environment and society”. It consists of 12 “apply and explain” principles for asset managers and asset owners and 6 principles for services providers, all supported by the FRC’s own reporting expectations.

Following the Kingman Review, the new Code places a far greater emphasis on the activities and outcomes of stewardship. This includes, for example, how investment and stewardship activities take account of ESG issues, the need to take account of client and beneficiary needs and for activities and outcomes to be properly communicated. The Code also broadens its focus across asset classes, to include listed equity, fixed income, infrastructure and overseas investments. The FRC does not prescribe a single approach to effective stewardship, and allows organisations to meet the expectations in a manner that is aligned with their own business model or strategy.

Stewardship in action

Nest, **TPT** and the **People’s Pension** are the only master trusts who go into depth on climate change in their ESG policies. They point to reducing the carbon emissions of portfolios as well as robust stewardship. While climate change fits under the ESG umbrella it is also worth separate consideration given its systemic nature. It was specifically referenced as an ESG factor in the regulations for this reason. Climate change should be a specific focus for stewardship and collaborative engagement. Collaborations such as Climate Action 100+ have shown the impact of collaboration on stewardship. **People’s Pension** mentioned the need for more collaboration and **TPT** is already actively involved in the Institutional Investors Group on Climate Change (IIGCC).

Although climate change is a crucial issue for consideration, it is important to remember that the new regulations refer to environmental factors alongside climate change. Trustees should therefore be looking at other environmental factors. For example biodiversity loss is, like climate change, a systemic risk with the potential for widespread impacts globally .

TPT and **Nest** are the only master trusts that talk explicitly about social factors, such as the living wage, in their engagement. Social factors are often financially material and can also overlap with environmental and governance issues: for example, achieving a just transition to a low-carbon economy. A just transition seeks to transition the economy to low-carbon whilst ensuring the transition is fair to those (such as workers in high-carbon sectors) who stand to lose out.

Finding 3

Master trusts show low levels of engagement with policy makers on the low-carbon transition

Mercer's report, *Investing In A Time Of Climate Change – The Sequel*^{xii}, points to returns being higher across the board if we manage to mitigate rather than adapt to climate change. We saw no master trusts actively speak out about the need for stronger climate action from government to protect their future returns and members' futures. The finance industry is often engaged with government policy when it affects them. Climate change will affect us all and investors have a unique voice to sound the alarm. They should use it.

In our ShareAction's best practice survey^{xiii}, the Church Commissioners discussed the importance of driving improvements in public policy (especially around the setting of economic incentives such as carbon pricing and aligning with the goals of the Paris Agreement) in accelerating the low-carbon transition.

It is alarming investors are not already more involved in public dialogue about climate change and policies to mitigate it, given pension funds are investing ordinary people's money. The Church Commissioners are a good example of an investor speaking out on what needs to happen.

TCFD

Investors could help progress action by policy makers by calling for TCFD to be mandatory and reporting against it. In mid-2019 the UK Government released its Green Finance Strategy which laid out an expectation for all listed companies and large asset owners to disclose in line with the TCFD recommendations by 2022. Furthermore, the Pensions Regulator has in conjunction with other government departments established a Pensions Climate Risk Advisory Group (PCRIG)^{xiv} that in 2020 will provide practical guidance for pension trustees on how to integrate, manage, and report on climate risks using the TCFD recommendations.

This review finds that only **Nest**, **TPT Retirement Solutions** and **LifeSight** have already begun reporting in line with TCFD. Recent research by ShareAction^{xv} recommends that asset owners adopt the TCFD recommendations. The recommendations not only help prepare for public disclosure but constitute a valuable framework that encourages holistic and connected thinking on financially material climate-related risks and opportunities. Furthermore, TCFD can be used as a framework to engage with companies thereby improving climate related data from companies.

Finding 4

There has been an increase in take up of ESG/climate funds into master trusts' default asset allocation

When we published our [Auto-Enrolment survey](#) in June 2018 looking at a similar range of schemes, **Nest** were the only master trust that had implemented a climate tilt in their default investments. Our research suggests that now eight master trusts have taken steps to incorporate a climate or ESG tilt into their default portfolio with another six discussing the possibility with their asset managers. In 2018, pension schemes made up 63%^{xvi} of asset managers' client base. We anticipate that asset owners asking for ESG-related products and services will help the overall market for such products and services to develop.

Interestingly, master trusts have chosen a variety of ESG funds which points to the developing nature of ESG and responsible investment. Passive products remain a popular choice but some schemes have chosen an active product and **LifeSight** have chosen both an active and passive fund.

Table 1:
Examples of ESG/climate funds master trusts are using in their default

Scheme	Fund name	Passive/active	ESG or climate tilt	Percentage of equities the tilt covers
Aegon	Capital Group	Passive	ESG	Up to 30%
LifeSight	MSCI Adaptive Capped ESG Universal Index	Passive	ESG	30%
LifeSight	Robeco Sustainable Multi-Factor Equity	Active	ESG	30%
Mercer	Mercer Sustainable Global Equity fund	Active	ESG	5%
Atlas	Schroders Sustainable Multi-Factor Equity fund	Active	ESG	100%
NEST	UBS Climate Aware Fund	Passive	Climate	30%-40%
TPT Retirement Solutions	Low carbon index fund	Passive	Climate	10% of the default fund
People's Pension	Multi-factor climate fund	Passive	Climate	21% of the default fund

We applaud **Atlas** for applying their ESG fund to all their equities. We would also hope that master trusts would incorporate ESG/climate across all their asset classes like the Future World Multi-Asset Fund created by Legal and General Investment Management.

Some schemes are taking a cautious approach to extending the ESG/climate/low-carbon tilt of their funds due to a concern that such an approach may impact returns. For example:

“The Trustees believe that whilst some Environmental, Social and Governance factors (for example, well governed companies) can clearly enhance returns, there is still insufficient evidence to demonstrate convincingly that all ESG factors are return enhancing”.

We would point to the meta-study by Deutsche Bank in 2016, which showed no negative correlation between ESG and financial performance^{xvii}. We note that schemes may be cautious with the idea of extending their tilts and ESG funds due to a lack of data on returns. There is a risk that if schemes wait too long for data on how ESG funds perform they will not benefit from the investment opportunities. Furthermore, it is worth drawing a distinction between data on issues like climate change and data on issues such as those falling under the “S” or “social” of ESG. Climate change is the most well-understood and quantified of the ESG risks, with numerous services and analyses available as investment tools. The forward-looking nature of climate risk also means that trustees cannot afford to wait for a demonstrable link between climate integration and financial returns before taking action. In addition, by using and interacting with current data and ESG metrics investors can reveal the data gaps and demand improved disclosure from companies. Improved disclosure is a key factor in improving returns as risks and opportunities can be more easily valued into stock prices.

Training for trustees on responsible investment was referenced by the **Aviva** and **Smart Pension** master trusts although it is implied in other policies. ShareAction supports increased education for trustees as ESG factors change and materiality of certain factors changes over time. Training is a key factor of good climate governance and supports the management of climate issues.

Finding 5

High scoring master trusts show signs of acknowledging the impact of investments on society and the environment

The finance industry has so far thought of responsible investment as a way to manage risks. Trustees in the pension industry have a specific fiduciary duty to act in the best interests of their members and this has historically been understood as a need to achieve the highest possible returns, often in the short-term. However, there has been a move away from this characterisation since the Law Commission's 2013/4 review on pension trustees' fiduciary duties^{xviii}. The regulations are a reflection of the need for greater clarity in law of the nature and scope of trustees' duties, which include consideration of ESG factors.

Investment by pension schemes and other institutional investors does not happen in a vacuum: it has an impact on the world, the environment and society. More progressive master trusts appear to be recognising this in their RI policies and practices. This marks a significant shift away from the above historic characterisation of fiduciary duty. For example,

Aegon, Aviva, LifeSight, Atlas, Smart Pensions and **Nest** all show evidence of thinking more holistically about responsible investment. Atlas Master Trust had an especially poignant statement on impact:

"It isn't possible to ignore the fact that investing in the global economy necessarily contributes to the environmental threats that our planet faces - global warming, deforestation and desertification, pollution, species extinction, extreme weather patterns and rapid exhaustion of natural resources".

The next step for master trusts is to put these statements about impact into action. In practice this could cover a range of activities including pushing asset managers for more information on the environmental and social impact of their current investments, developing stewardship policies that consider the impact of assets, and looking for investment opportunities focused on positive impact. **Nest** has already taken a step by investing in private credit, which allows for investments that are more tangibly providing solutions to world issues.

Member engagement

The idea of impact is also relevant to member engagement. Under the new investment regulations, schemes must explain the extent to which they will take into account the views of members in preparing their statement of investment principles. Schemes spoke of ESG risks being especially applicable to DC savers with long-term investment timelines meaning they would likely experience the real-world effect of their investments directly. **Aegon** referred to members wanting to know where their money is invested. ShareAction anticipates this is a trend that may increase as members start to learn more about their pension investments.

Atlas go further and state “We have also carried out a review to take into account non-financial matters in respect of our investments, including but not limited to members’ and participating employers’ ethical views”.

This statement represents a step change in the way pension schemes think about their members, who are the ultimate beneficiaries. It is important to note that trustees are able to seek members’ views and, where appropriate, to reflect them in their investment and stewardship activities without compromising their discretion as trustees. And it is encouraging that in this review, in total fourteen master trusts refer to action on member engagement in their SIPs. Schemes refer to surveys, forums and telling stories about responsible investment as ways to engage their membership.

Concluding remarks

Positive progress has been made by the 16 master trusts reviewed but there is clearly a lot more to do, especially on climate change. It is positive to see eight schemes changing their asset allocation to incorporate ESG and/or climate change factors. The increase in ESG strategies is a real success and the increase in products should make it easier for other schemes to incorporate ESG.

The regulations referred to in this report are only the first step. The world is facing a climate emergency, ecological crises, and inequality is rife. This demands bolder, smarter thinking fit for the 21st century. Policy makers should consider that in addition to risk and return, investors like master trusts should also be charged with thinking about the impact their investments have on the world and taking this into account. Some master trusts have shown signs of a new narrative around investing and what impact pension investments have on members' lives. The next step is to communicate this to asset managers so they report back to asset owners' and perhaps create more holistic models of retirement outcomes, which take account of wider global trends, not just short-term investment returns. It seems likely that, in time, members will demand this kind of thinking, as they learn more about their investments and become more engaged with how their money is used.

What we need to see next is action and hopefully the implementation policies, which schemes have to produce next year, will show this. Rather than delegating, asset owners have an opportunity to embrace responsible investment and secure future sustainable returns as well as create a better world for their members to retire into. Trustees need to be responsible for setting the tone, and integrity of all stewardship undertaken on their behalf.

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Fairshare Educational Foundation (ShareAction) is a company limited by guarantee registered in England and Wales (number 05013662 and registered address Ground Floor, 16 Crucifix Lane, London, SE1 3JW) and a registered charity (number 1117244). VAT registration number GB211 1469 53.

About ShareAction

ShareAction (Fairshare Educational Foundation) is a registered charity that promotes responsible investment practices by pension providers and fund managers. ShareAction believes that responsible investment helps to safeguard investments as well as securing environmental and social benefits.

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