INVESTMENT

Changing mindsets

Andrew Williams explores the attitudes towards ethical investment across Europe

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In recent years there has been a gradual shift in the nature of European pension funds' attitudes towards ethical and socially responsible investment. So, how do these attitudes differ across Europe – are some looking at divestment, while others look at investing in renewable energy? And have conversations with European pension funds moved on from ethical investment being viewed as something that would cost returns to something that is now considered cost effective?

Niche to mainstream

According to Amundi's chief investment officer, Pascal Blanqué, European pension funds' vision of ethical investment, often also known as environmental, social and governance (ESG) investing, has changed considerably over the past few years – and evolved from a niche to a mainstream topic. In particular, he reveals that pension funds now increasingly price climate risk into their portfolios, a trend that has "progressively gained traction as pension funds have realised that climate risk embeds a significant social, financial and reputational risk".

Following a raft of new regulations – such as IORP II at the European level, as well as changes within individual countries – Blanqué points out that pension funds are now also increasingly obliged to integrate ESG factors into their investment policy.

"Aside from these regulatory constraints, ESG investing has now become a key element of strategic expertise to address the long-term risk inherent to their liabilities," he says.

Elsewhere, Create-Research's CEO, Amin Rajan, points out that a 'hard-nosed' approach to ethical investing is now emerging, characterised by pension funds seeking to manage reputational risks, earn competitive returns and manage the newly-emerging climate change risks – all in order to deliver tangible societal benefits.

"A new narrative is emerging: sustainable, long-term returns require a sustainable economy and society," he says.

Meanwhile, Cometa's director general, Maurizio Agazzi, agrees that sensitivity towards themes like sustainable and responsible investment has undoubtedly increased in recent years, both within the pension system as well as across the financial sector more generally.

As far as Cometa is concerned, he explains that the existing strategy is to incorporate ESG into its investment policy in a way that goes beyond the mere search for returns and looks at the creation of value and wellness for the whole of society. Cometa's path towards responsible investment started in 2010 with adherence to the UN Principles for Responsible Investments (PRI), and since then Agazzi says the fund has maintained its commitment in a number ways – including close monitoring of its portfolio.

"In 2016, on the occasion of the renewal of the management mandates for the fund's compartments, we considered the SRI/ESG models and standards adopted by participants, as well as their agreement to the PRI initiative, among the parameters to select the investment management firms. We've been the first complementary pension fund in Italy to use this parameter in the selection process," he says.

Differences in approach

In terms of the overall approach to ethical investing, Rajan believes there is not so much a divergence in strategies as on emphasis within the overall ESG framework, with the

French focusing on climate change, the Scandinavians on social issues and the British on governance.

As far as ESG integration and approaches to climate risk are concerned, Blanqué also believes that pension funds attitudes differ across Europe – with ESG becoming mainstream and pension funds starting to integrate climate-related issues into investment policies in what he describes as the most advanced countries in terms of ESG integration like the Nordics, Netherlands, UK and France.

In Nordic countries, especially Sweden, he highlights the fact that AP funds combine several strategies, including exclusions, engagement and voting as part of a holistic approach to integrating ESG factors into investment policy, process and decision making. Meanwhile, in the Netherlands, he argues that basic ESG integration is becoming mainstream, with 94 per cent of pension funds applying at least some ESG criteria in the evaluation of equity investments. In France, Blanqué also observes that the best-in-class approach is the main strategy combined with exclusion and engagement and voting.

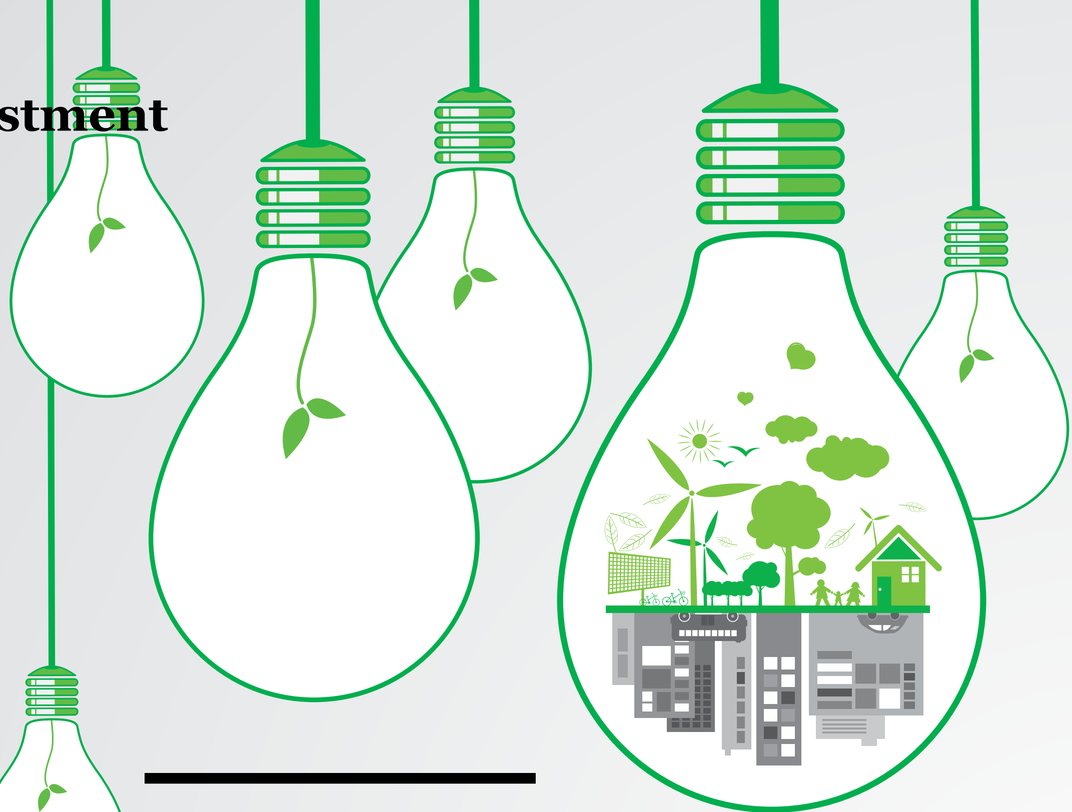
A hundred per cent of the French Reserve Fund (FRR) investment followed a best-in-class approach and the French civil servants complementary pension schemes (ERAFP and IRCANTEC) integrate ESG considerations in close to 100 per cent of their investment, he says.

"In the UK, pension funds have been requested to integrate ESG factors into their investment policy. In Italy, Spain, Switzerland and Germany, pension funds are also showing an increasing commitment to SRI *[socially responsible investment]*, but there is still room for improvement," he adds.

When it comes to climate change strategies, Blanqué observes that some European pension funds have decided to focus more on decarbonisation while others concentrate on investing in alternative renewable energies. In particular, he says that a "decarbonisation movement" has started in several countries like France, Sweden, Germany, UK and the Netherlands, where pension funds are committed to divest part or all of their fossil fuel assets. In 2014, Amundi also co-founded the portfolio decarbonisation coalition, which includes more 27 investors, such as the French Reserve Fund (FRR) and the French civil servants complementary pension schemes (ERAPF), AP4 in Sweden and the Environment Agency Pension Fund (EAPF) in the UK.

A NEW NARRATIVE IS EMERGING: SUSTAINABLE, LONG-TERM RETURNS REQUIRE A SUSTAINABLE ECONOMY AND SOCIETY

"This coalition of now 32 investors ... have committed to align over $800 billion of their portfolios



with a low carbon economy. All consider engagement, decarbonisation and low carbon investments more effective than divestment," he says.

"Other European pension funds will focus in alternative renewable energies like the Danish institutional pension funds that are highly involved in alternative investment with a focus on low-carbon and climate-friendly infrastructure and Spanish pension funds, that have a growing interest in themes relating to renewable energy," he adds.

Cost effective?

Generally speaking, Blanqué believes that ethical and sustainable investing "does not come at the detriment of financial performance" – and he points to aggregated evidence from more than 2,000 empirical studies, which has found that the business case for responsible investing is empirically well founded, with roughly 90 per cent of studies finding a "non-negative relationship between responsible investment and financial performance".

"On the contrary, an important majority of the studies actually even report positive findings. Although this second element could be discussed, our belief is that responsible investing does not hinder financial performance," he says.

"The actual costs of implementing responsible investing are also decreasing, facilitating this mainstream movement. The evolution of the industry, with greater demand for tailor-made products and services that go beyond asset management, have gone hand-in-hand with demands for responsible investment frameworks and solutions, and have resulted in mainstreaming responsible investment to most asset managers, with responsible investing becoming no longer a 'boutique affair', but rather a shared concern," he adds.

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Meanwhile, Rajan points out that COP21 was a "game changer" and has led to markets starting to price in climate change risks.

"More generally, though, pension investors are consciously looking beyond blind spots that come from short-termism and seeking to detect and manage long-term risks that are unfamiliar to the conventional risk models," he says.

Ultimately, Agazzi argues that a pension funds' decision to increase awareness of its responsibility towards wider themes – such as sustainability or ESG factors – not only fulfils an 'ethical' objective, but is also firmly in line with the mission of funds themselves, including its duty to protect their investments and also its members' savings.

"A responsible and virtuous approach in a pension fund's investment policy allows it to generate value for the society as well as protect its investments – and so its members' savings: for example, from the negative effects that may occur if a company they are invested in should take a non-ethical approach," he says.

"In this case, the company could see not only reputational, but also financial damage, which could then impact the investments of the pension fund. So, we believe that responsible investment is not only an ethical but also an intelligent approach, in line with the purposes and the nature of a pension fund," he explains. ■