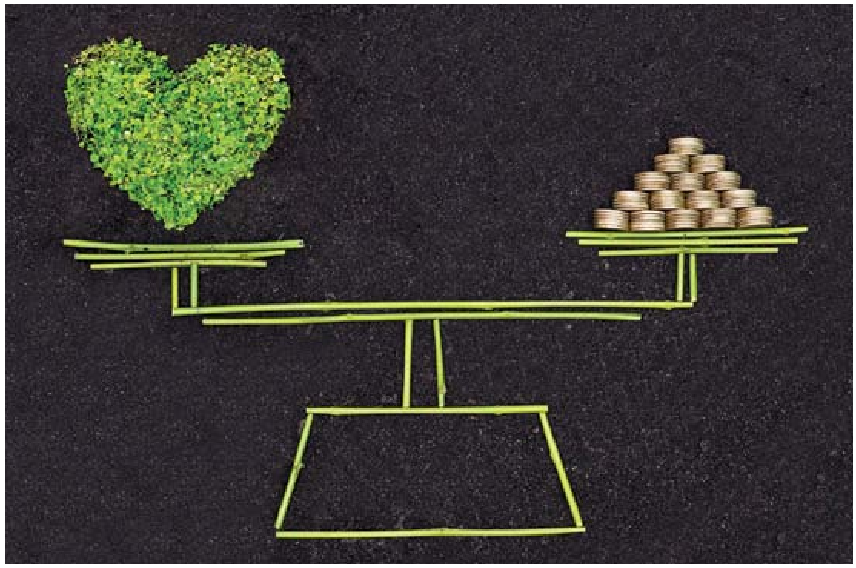

INVESTMENT

# A holistic view

**Andrew Williams looks at European pension funds' attitudes towards ethical investment**

**WRITTEN BY** ANDREW WILLIAMS, A FREELANCE JOURNALIST

Ethical investment – often also called sustainable and responsible investment (SRI), or environmental, social and governance (ESG) investing – has grown in importance amongst pension fund managers in recent years. So, is there now an increased focus on ethical investing amongst pension scheme managers – and what is the motivation? And how do attitudes towards ethical investing amongst pension scheme managers differ across European regions and countries?

### Noticeable shift

According to BNP Paribas product sales specialist, Trevor Allen, there is definitely a noticeable shift in the market towards ethical investing, influenced by a combination of factors. In his view, major motivations include pension fund portfolio managers looking for investment opportunities, for example from the shift towards renewable energy, and pension fund members enquiring how their money is being invested.

"For example, we have seen increasing pressure on pension funds to be able to address the concerns of investing in certain businesses such as tobacco or tar sands exploration. We currently see very few pension funds treating ethical investment as a box-ticking exercises. Most pension fund managers are looking deeper to understand how they can focus on ethical investment to reduce their risk profile and improve overall returns," he says.

Vigeo Eiris director of external affairs Stephen Hine reveals that, although many funds consider ESG issues from a perspective of financially material risk, as well as opportunity, some also apply ethical screens.

This is particularly so in the Nordic region, where companies that have particularly egregious allegations against them, or that do not respond to active engagement by the asset owner or manager, or where the financial risk is deemed too great, may be excluded.

In Hine's view, this reflects an effective consensus that investment practice should reflect international norms. For example some may exclude coal companies because the coal reserves are effectively 'stranded assets', meaning that in a climate-constrained world it will not be possible to extract them.

"However, the bulk of pension funds, including in the Nordic region, which implement ethical investment, focus on analysing ESG risk. This is in line with the now common interpretation of fiduciary duty as requiring asset owners to take account of ESG issues that can affect the long-term returns on their investments," says Hine.

"Given that pension funds have a need to be stewards of capital over a long period of time to pay out to current and future beneficiaries it is crucial that they pay heed to risks, including ESG risks, that could impede their ability to meet these obligations," he adds.

### Holistic perspective

Elsewhere, Candriam global head of client relations - Europe and Middle-East, Renato Guerriero, observes that there is now an increased focus on sustainable and responsible investments, and that ethics are a part of this trend.

For him, the phenomenon can be likened to recent developments in the automotive industry where, just a few years ago, he says most people would buy a car based on its technical capabilities such as speed and power, but also status – whereas now people are looking more towards safety, efficiency and CO2 impact and are prepared to pay a premium for these new criteria.

"The same thing is happening in the pensions industry. Investors are looking past outperforming a benchmark and simply achieving returns. They are increasingly factoring in risk mitigation from a more holistic perspective, limiting their reputational risk, the impact of their investments on the environment and climate concerns," he says.

"These items are very high on the agenda of many asset owners. The focus has become more relevant also in response to regulation and to the moral suasion many governments are exerting in order to make more resources available towards a pretty much needed energy transition. Bottom-up there is also strong pressure on corporate ethics, that is on the behaviour of top management, respect for shareholders, in particular minority shareholders, and finally for fair remunerations of top managers," he adds.

Meanwhile, BESTrustees trustee executive Bob Hymas points out that trustees have an obligation to deliver the benefits members expect, which requires a clear objective and investment strategy.

However, although he believes ethical investments may play a part when setting such objectives and strategies, he stresses that they should not introduce undue inefficiency or compromise. As a result, he argues that all the characteristics of an investment must be considered from a trustee perspective.

"To me, that does not give any specific weighting to ESG, but it is not ignored. If ESG is a substantial issue to the scheme stakeholders, any particular characteristics would need to be factored in at the objective setting stage of the process," he says.

Because pension schemes are usually long-term investors and transaction costs are a headwind to investment performance, Hymas also believes that investments should be based on an expectation of sustainability and he highlights the fact that there is undoubtedly pressure on corporates to meet stakeholders ESG expectations.

"The oil majors are a good example, as their businesses evolve towards renewable energies. As a result, in seeking sustainable investment, there is almost certainly investment in corporates that take ESG issues more seriously," he adds.

The UK's Universities Superannuation Scheme (USS) co-head of responsible investment, David Russell, also reports that more organisations are recognising that ESG issues can impact the value of investments, and that the number of pension funds and asset managers incorporating ESG data in their investment process has increased. Whilst less usual in the UK, he reveals that some pension funds across Europe also take ethical or moral positions with their investment decisions, and will not invest in companies in certain sectors or operations in certain countries.

"At USS, we believe that companies and assets with responsible environmental and social practices and strong governance structures have the best chance of producing superior, sustainable long-term returns," he says.

## Regional variations

When it comes to regional variations in focus, Hine observes that the leaders in ethical and responsible investment are often those looking after large pots of money for entire countries, states or provinces – meaning that large national pension or regional funds in places as diverse as France, New Zealand, California, Japan, Norway and Alberta are leaders in this field.

Whilst this may reflect factors such as regulation or political consensus, Hine believes this also reflects a realisation that "as investors in all aspects of the global economy across multiple asset classes – what are known as universal owners – they cannot externalise risk, and therefore have a duty to ensure that material ESG factors are taken into account".

This also means that they are frequently leaders in engagement with the companies in which they invest, he adds.

"This may be done directly or via their fund managers. This dialogue enables them to affect the policies, management systems and behaviour of companies," Hine says.

Meanwhile, Allen points out that the Nordic region in general is "definitely at the vanguard on investing in renewable energy and very advanced, with very little or almost zero investment in tobacco or oil".

According to Allen, "it would not be an exaggeration to say that almost all European pension fund managers are increasingly looking for opportunities in renewable energy, which is partially predicated on the COP21 agreement helping to shape the market for renewable energy".

Generally speaking, Guerriero also argues that the development of responsible investment associations such as EuroSIF – as well as its local members such as UK SIF, French SIF and Italian SIF – have contributed to more standardisation and common understanding.

"To sum up, if historically there were larger differences across countries, today we converge towards some common understanding and this is good news," Guerriero adds. ■