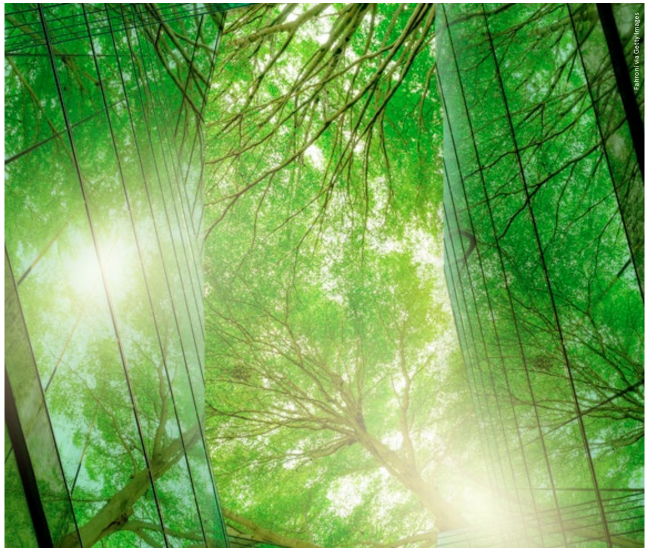
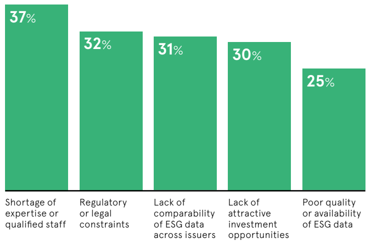


Fahroni via Getty Images

OBSTACLES TO ETHICAL INVESTING

HSBC, 2021

Share of institutional investors and capital market issuers citing the following as key obstacles hinding the broader adoption of ESG investing worldwide in 2021



REGULATION

Westminster and its watchdogs toughen the ESG reporting regime

UK regulators are obliging scheme trustees to review how they consider and disclose the environmental, social and corporate governance liabilities in their schemes' investment portfolios

Alex Wright

The issue of environmental, social and corporate governance (ESG) reporting has ascended many companies' agendas in recent times as climate change becomes ever more of a concern for business. This is especially the case in the pensions sector.

The UK government has already started introducing significant legislation to control how investment managers market their funds and report on their performance, with a particular focus on ESG. The latest proposals from Westminster are aimed at obliging occupational pension schemes to make ESG considerations a core part of their decision-making processes.

The current regulations already require the trustees of any scheme with 100 or more members to produce a statement of investment principles (SIP). This sets out the policies determining how funds are invested, including financially material ESG and climate considerations. The trustees must also detail their stewardship policies and the extent to which members' views on non-financial matters are taken into account in the selection, retention and realisation of investments.

The SIP must be published annually, along with an implementation statement (IS) explaining how the trustees have put their principles into practice. In addition, master trusts and schemes handling more than £1bn of assets must publish an annual climate-change or Task Force on Climate-Related Financial Disclosures (TCFD) report.

But this regime is set to become even more stringent. In February, the Pensions Regulator started a campaign aimed at ensuring that trustees are meeting their ESG and climate-change reporting obligations. In March, the government published a strategy paper entitled *Mobilising Green Investment*, which contains measures that will oblige stakeholders to clarify trustees' fiduciary duties in light of the transition to net-zero CO_2 emissions by 2050. In the same month, it opened a consultation on whether ESG ratings agencies should be brought under the control of the Financial Conduct Authority.

The Pensions Regulator is also due to conduct a review of SIPs and ISs this year. Where it finds cases of non-compliance, it has the power to fine offending trustees (if they are corporate bodies) up to £50,000.

The main aim of all this regulatory tightening is "to encourage trustees and their advisers to make decisions that take ESG considerations into account", observes Dale Critchley, policy manager, workplace benefits, at Aviva. "These concentrate on the financial implications of ESG risks but can include non-financial factors too, where the trustees are confident that their members would want these to be considered."

He adds that the authorities have two further objectives. One is to ensure that the trustees "put action plans in place and review the outcomes". The other is to put pressure on schemes to "align with the views of members".

Despite all these new stipulations, the government has stressed that it's not telling trustees how to allocate their funds. Yet there have already been significant changes in investment behaviour since the rules took effect.

Given that trustees must consider their fiduciary duties, they need to be clear when setting out the link between climate-related risks and opportunities and the financial implications for investors. Many have also been looking to make voluntary net-zero commitments regarding pension fund assets, which is fast becoming standard practice.

Plenty of guidance has been published to ensure that trustees meet their ESG obligations. The Department for Work and Pensions, the Pensions Regulator, the Pensions and Lifetime Savings Association and the Pensions Climate Risk Industry Group have all provided detailed information about their duties with respect to climate regulations and other stewardship and disclosure requirements.

Some experts fear that the large volume of rules and instructions for following them could prove more of a hindrance than a help. Stuart O'Brien, a partner specialising in pensions at law firm Sackers, is one of them.

"The information on reporting requirements is there for those with enough time to wade through it," he says. "But, with all the disclosure obligations and guidance being published, there is a danger that trustees might get regulatory fatigue. This will need to be considered as new sustainable disclosure requirements come into effect."

Kim Nash is MD of Zedra Governance, where she works as an independent trustee to several pension schemes and heads the Geneva-based firm's office in Birmingham. She believes that trustees will "need the support of the investment community, along with their advisers, to be able to meet all these requirements. It will necessitate the allocation of resources – both time and money – to ensure that risks are identified and mitigated properly and that the external reporting is compliant."

Despite the strides they have made in ESG reporting, trustees will inevitably encounter some difficulties in complying with the new rules. Chief among them is the lack of clarity concerning how the subject is communicated. Larger schemes may struggle with the complexities of TCFD reporting. Smaller schemes may find it hard to afford expert advice on ESG risk mitigation. They're also likely to have relatively little influence over investment managers.

Another problem is that the underlying information necessary for disclosing schemes' climate-related metrics remains patchy at best. Given that trustees are required to disclose the scope-three carbon emissions (those caused by activities from assets in the value chain that are neither owned nor controlled by the reporting entity) of their portfolios in the second year of TCFD reporting, there are likely to be significant gaps in their data.

There will be "challenges and inconsistencies with climate data over the next couple of years. These will continue until we get to a point of standardisation across the industry and it's fully implemented within firms' reporting," predicts Ryan Medlock, senior investment development manager at Royal London.

"The first hurdle is ensuring that the right data is in place and published to meet the regulatory requirements," he adds. "The second is thinking about how we use this data across the industry in a more meaningful way for customers."

> **With all the disclosure obligations and guidance being published, there is a danger that trustees might get regulatory fatigue**

Commercial feature

Pensions and beyond: the power of financial confidence

To deliver a better financial future for all, leaders in the pensions and savings industry – and employers – must adopt a more forward-thinking and positive approach that embraces technology and education

The UK pensions industry is steeped in tradition, but it's also constantly learning from other industries that are already ahead of the game. It must now harness new innovations and modernise to meet people's needs as priorities and preferences change. Understanding what will ignite interest across the different generations is critical here. The future for savers and pension scheme members looks even brighter if they can pursue their financial journey with confidence.

That is why industry leaders must adopt a positive and forward-thinking approach, harness the power of technology and put better member outcomes at the top of their agenda. This will enable them to steer a clear path to a more efficient and effective pension system that works for everyone.

It is a vision shared by consultancy Isio, one of the largest pensions advisory businesses in the UK, which has been challenging current thinking on pensions, benefits and investment advice since it launched in 2020, with a relentless focus on innovation and improvement in this market.

"Our aim is always to challenge the status quo," says Andrew Coles, CEO of Isio. "That means we can't accept that what has worked in the past will always work in the future, so we're continually striving for improvement."

Engagement and building confidence

Everyone generally agrees that financial education should begin in schools, in the early years, but the workplace has a massive role to play too in building financial confidence. Employers have a strong trust and information advantage over others when it comes to building and supporting their employees to get the most from their finances – and not just when they reach retirement.

"The ultimate aim is to create more confidence in the savings environment and help people to understand the importance of saving for the future and prioritising in the right way," says Coles.

Given the current cost-of-living crisis, it is critical that people learn to manage their finances. That means understanding what people's short-, medium- and long-term needs and goals are, and giving them the right set of tools whether they're an expert or a complete novice.

All of this must be brought together to form an overall financial strategy that focuses on savings as well as pensions. Knowledge empowers individuals to make better-informed decisions about their finances, but it's the tools and hands-on support that help individuals to build this knowledge, to allow them to make better-informed decisions. This philosophy is embedded in Isio, which works with the charity MyBnk to help improve young people's financial education, as well as a financial coaching team providing guidance and support to employees.

The crucial role of technology

The biggest enabler of financial confidence and health is technology. Investing in technological infrastructure and solutions gives firms much greater efficiency in terms of their data manipulation and transfer abilities, alleviates the pressure on their administration team, reduces their risk and enables greater auditability. For employers, it allows them to gain deeper, real-time insights into their workforce.

A money health check tool that Isio offers does just that. Recognising that tackling finances is a daunting task, a five-minute journey allows individuals to start on that path, allowing them to see the key areas that they should address. This in turn provides valuable data that employers can use as a key component of their financial wellbeing strategy.

"From a member's standpoint, they will receive a real-time service and be able to carry out everything they want to do online, as well as having a far broader view of their finances," says Vito Faircloth, chief digital officer at Isio. "The hardest part is starting, so a frictionless experience with clear actions can help them to see the value of getting their finances in order, particularly at this difficult time. A great example where we have done this has been with a large public-sector body, supporting them with staff retention. That combination of a frictionless technological experience and personable, emotive support delivered by our coaches is delivering great outcomes for our clients."

> **Our aim is always to challenge the status quo. That means we can't accept that what has worked in the past will always work in the future**

> **A frictionless experience can help members to see the value of getting their finances in order**

Faircloth also points out the exciting opportunities for innovation around data sharing. "It went from open banking to open finance, didn't it?" he says. "Now, we've got some bold views as to how it's moving more towards open data. Pensions and finance shouldn't be looked at in isolation, because there's a direct link between someone's financial wellbeing, their emotional and mental wellbeing, and even their physical wellbeing. It all needs to be looked at as one overall wellbeing plan for members. So, having upgraded, innovative systems allows the employee to start to amalgamate that data and get to the outcome of taking tangible steps to improve their wellbeing faster."

The market is ripe for disruption here, and an acceleration in change is expected over the years to come – not just in financial and broader wellbeing, but in the whole pensions and investments market. Artificial intelligence is allowing the industry to interrogate ever-expanding datasets at an exponential rate, providing much deeper analysis to employers and trustees, and allowing companies like Isio to adapt, in real time, to the learning preferences and pressing issues that members face. A future consisting of a personalised technological experience for customers is real.

Organisations need to be advancing their thinking here in order to play a key role in driving a pensions and savings sector full of exciting technological possibilities. Chatbots, augmented reality and virtual reality can be used to enhance the member experience further, to a point where they can do everything without needing to leave the comfort of their home. This is the future of pensions.

A forward-thinking, collaborative future

Workplace pension schemes remain the cornerstone of the industry, but they too must evolve to reflect society's ever-changing needs and attitudes. Essentially, what people want is a plan that's easy to understand, cost-effective and flexible. Organisations should also be thinking about what they can offer beyond pensions too, as this is a rapid area of growth.

To drive this change, the UK government, employers and the pensions and savings industry need to work together. Legislative and regulatory policy must be shaped in line with investors' needs, employers must ensure that employees receive the financial advice and support needed to make the right choice, and savings firms must provide the best possible financial products.

"To succeed, the pensions sector needs to adapt to new ways of working. We all need to work together moving forward," says Coles. "Only by challenging the past can we ensure a better financial future for people."

For more information visit isio.com or email at curious@isio.com