

PENSION RISK STRATEGIES

The landscape of ESG (environmental, social, and governance) and sustainable investment in the context of managing workplace pension and retirement plans is quickly evolving, says Bonnie Foley-Wong (CPA, CA, CFA), Sustainable Investment Leader at Mercer.

Speaking in the Benefits and Pensions Monitor Meetings & Events session on ‘Pension Risk Strategies’ with Julianne McHugh, Head of Sustainable Equities at Newton Investment Management, Foley-Wong said the origins of sustainable investment and ESG are in ethical investing as people protested against the investment in companies that made weapons, produced tobacco, or exploited the labour of enslaved people by not investing in those stocks. ESG was coined in a 2005 study by the United Nations Global Compact. ‘Who Cares Wins’ – Connecting Financial Markets to a Changing World’ which was endorsed by 20 global financial institutions and asset managers.

These early concepts are still present in today’s sustainable investing, but there is an increasing recognition that they have real-world meaning in terms of financial security and retirement savings.

Intersection

Workplace retirement plans are at an interesting intersection between corporations and institutional investors as they think about ESG and sustainable investment. “Sustainability is becoming increasingly critical to the success and resilience of Canadian businesses, including how workplace plans are managed,” Foley-Wong said. Plan members want to know what their plans are invested in and to understand how to interpret the ESG impact of their retirement savings. This is challenging plan administrators to adapt how they communicate the features, benefits, and performance of workplace retirement plans.

Since plan administrators are bound by a fiduciary duty to act in the best interests of plan beneficiaries, there is increasing recognition that they have a responsibility to take a longer term and more systemic view of their duties and obligations. Market integrity, systemic risks, and governance risk have an impact on the long-term viability and resilience

of pension plans and, consequently, upon future generations of beneficiaries. This means taking ESG factors into account may be appropriate as well as prudent to meet fiduciary duties.

“What we’re seeing globally is investors are often starting their journey with a desire to understand the regulatory requirements that define their fiduciary duty. While they may recognize the benefit of an enhanced employee value proposition by investing responsibly and sustainably, they need to understand if and how the regulatory requirement environment may be evolving to reflect ESG risks,” said Foley-Wong.

There are different ways that plan administrators can achieve their investment objectives and raise their sustainability ambition including establishing sustainable investment beliefs and policies, rethinking investment processes and portfolios, and through employee communication and education.

Climate Risk Analysis

Some administrators are now regularly performing climate risk analysis on their portfolios while others are evaluating climate scenario analysis in connection with their asset liability modeling. “There is no definitive or standard approach to sustainability and investment processes,” said Foley-Wong.

Increasingly, as employers implement plans with more employee choice, there will be more questions in this area. Managers of workplace plans need to be thoughtful in terms of what information is shared and how to best equip plan members to make decisions that meet their financial risk and return objectives as well as any sustainability objectives they might hold.

The long and short of it is ESG factors are increasingly being integrated in the context of investments. All investors need to adapt to keep pace, she said.

Focusing on sustainability goes beyond just integrating the risks and opportunities within a P&L statement, said McHugh. It actually looks more at focusing on investing in companies that are making a positive contribution to society while achieving long-term sustainable returns. “We do believe that these strategies play an important role in institutional portfolios

because they thoughtfully consider real-world outcomes in pursuit of stable, long-term financial returns, ultimately aligning stakeholders’ interests,” she said.

However, they are operating in a complex and inter-connected ecosystem, which can make it really difficult to simplify real-world outcomes into a simple right or wrong, heads or tails conclusion.

An example might be assessing emerging markets’ role in the transition to the net-zero world. There’s an interconnectedness with climate change and poverty because many of the most vulnerable economic populations live in areas most exposed to environmental consequences. “So we need to address poverty in tandem with the climate change,” she said

There is also an interconnectedness with the absolute level of emissions produced within a global context. The headlines focus is on the large amounts of emissions that are generated by emerging markets. Emerging and frontier markets are responsible for about 75 per cent of global emissions, so clearly they are huge players on the path to a zero. But they are actually providing a carbon benefit to the developed markets.

Carbon Benefit

China is the leading solar manufacturer. It and Korea produce about 77 per cent of the electric vehicle battery market.

“When we assess the absolute level of emissions they’re producing, we should also consider the part that’s being generated to reduce emissions elsewhere in the world,” said McHugh.

There is also a greater growth opportunity to adopt renewable resources in emerging markets. Energy demand in these markets is still growing because these countries are earlier in their economic development. Their growth in the adoption of renewables is actually a lot larger than the developed world. They’re transitioning their fossil-fuel energy generation to renewable generation.

Therefore, when assessing how to promote sustainable outcomes, rather than only considering the absolute level of emissions, one must consider the components that influence the level and the timing of the goals to achieve ‘zero.’ **BPM**



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