CACEIS AND LOCAL GOVERNMENT PENSION SCHEMES

Part 4

The who's who and what's what of ESG

caceis
INVESTOR SERVICES

This section of our guide covers many of the terms you are likely to hear from fund managers and other third parties when discussing ESG. We hope it will help you gain a clear understanding of what they mean for your investments and enable you to be confident in fulfilling your fiduciary duty.

We have also included some of the organisations you might encounter on your sustainable investment journey and how they fit within the ESG universe.

A key point to note is that each company and organisation has a distinctive approach to the way they go about assessing ESG risks and turning their theories into practice. As a fiduciary of long-term investments and benefits, you should not be put off from asking any of them to explain their approaches.

PRINCIPLES FOR RESPONSIBLE INVESTMENT

In 2005, the United Nations founded the Principles for Responsible Investment (PRI), drawing from discussions within a steering group of 70 people, gathered from 20 institutional investors. Launched in 2006, the PRI sets out a voluntary code of six core principles that asset owners and managers can implement to guide their approach to responsible investment.

Signatories to the PRI publicly commit to adopt and implement these principles and must report on their adherence and progress each year. The UNPRI organisation then assess signatories on whether they are living up to the required standards and can issue calls for improvements. The assessment is based on ESG strategy, governance, innovation and integration for each asset class the signatory operates in and is part of the world's largest reporting schedule for responsible investments.

As the six core principles need to span the entire investment universe, they are very broad and can help set a strategic framework for a pension fund's ESG policy.

https://www.unpri.org/pri/about-the-pri

INSTITUTIONAL INVESTORS GROUP ON CLIMATE CHANGE

IIGCC is a European membership body that encourages asset owner collaboration on climate change and aims to mobilise capital to facilitate the transition to a low-carbon global economy. The group helps define the investment practices, policies and corporate behaviours that are required to address climate change and encourages investors to make their portfolios resilient to them – and seek opportunities.

https://www.iigcc.org/

TRANSITION PATHWAY INITIATIVE

This global, asset-owner led initiative assesses a company's preparedness for the transition to a low-carbon economy. It evaluates and tracks companies around the globe on their management of greenhouse gas emissions and the risks and opportunities they face related to the transition. It also considers how a company's future carbon performance compares to international targets and relevant national pledges made as part of the Paris Agreement.

The TPI was established by the Church of England National Investing Bodies (Church of England Pensions Board, the Church Commissioners and CBF Funds) and the Environment Agency Pension Fund. More than 60 investors globally had pledged support by June 2020, representing over $18trn combined assets under management and advice.

https://www.transitionpathwayinitiative.org/

CLIMATE ACTION 100+

Launched in December 2017 at the One Planet Summit, Climate Action 100+ aims to ensure the world's 100 largest corporate greenhouse gas emitters take necessary action on climate change. These 100 'systemically important emitters', account for two-thirds of annual global industrial emissions and therefore have significant opportunity to drive the clean energy transition.

By June 2020, it counted members and affiliates from more than 450 investors with more than $40 trillion in assets collectively under management. These investors collaborate on shareholder engagement action to encourage companies to plan for a low-carbon future.

http://www.climateaction100.org/

JARGON

Active ownership – Investor efforts to reduce risk and enhance long-term value. This can include voting company shares and/or engaging management and boards on ESG and business strategy issues.

Best in class – The approach does not rule out sectors that may seem to go against ESG themes but focuses on firms with a better environmental or social track record – or plans to improve – than others in their peer group.

Cleantech – A growing investment category representing products, services and processes that can reduce or even eliminate environmental impacts or demand lower resources. Cleantech is a theme rather than sector and may include investments in agriculture, energy, manufacturing, materials, technology, transportation and water.

Climate risks – Risks stemming from climate change that have the potential to impact companies, industries and whole economies. There are five key areas of business risk associated with climate change: regulatory, physical, litigation, competitiveness and reputation.

Corporate governance – Procedures and processes through which an organisation is directed and controlled, considering economic, social, environmental and ethical impacts in order to mitigate risk, decrease costs and improve brand image and competitiveness.

Corporate social responsibility (CSR) – This refers to companies' involvement in wider society. While it can include environmental activities and other ESG issues, it can also include philanthropic activities and ethical concerns.

Divestment – Selling or disposing of holdings based on corporate or official behaviour. It is often the last resort for investors.

Double bottom line – A term describing the combination of quantitative and qualitative analysis accepted by socially aware investors – in other words, making a return on investment and improving a company's operations in an ESG context.

Engagement – Fund managers and larger institutional investors seek to use their position as share or bondholders to drive change in a company either through dialogue or by exercising their vote at annual or extraordinary general meetings.

Environmental, social, governance (ESG) – The three key core components of environmental concerns, issues around people and communities and governance – and how they contribute to how businesses are managed.

Ethical investing – Investment philosophy guided by moral values, ethical codes or religious beliefs, typically associated with negative screening.

Impact investing – Investments that aim to make a measurable environmental or social impact in addition to generating a profit. Once confined to environmental and social concerns, impact investment now targets wider challenges.

Proxy voting – Delegating shareholder voting rights to a third party that can both implement the voting decision and offer guidance on how to cast a ballot.

Qualitative analysis – Analysis of company policies, practices, behaviours, and impacts that helps portfolio managers select those that fit its own strategy and rules.

Screening (negative/positive) – Selecting or rejecting assets on the basis of strict, pre-agreed criteria.

Shades of green – While 'green' investing refers broadly to environmental investment themes, the addition of qualifiers such as 'light green' or 'dark green' refers to how strictly a fund manager or institutional investor applies environmental, ethical or other sustainability policies to a portfolio.

Shareholder proposal/resolution – A request from a single or group of shareholders that a company or its board take particular action. It may be presented at an annual general meeting and be voted on by all shareholders.

Socially responsible investing (SRI) – A catch-all term that encompasses a wide spectrum of investment strategies including ESG issues.

Stranded assets – Company property or resources that lose value or turn into liabilities before the end of their expected economic life. Regarding fossil fuels, it means the oil, gas and coal that will not be extracted.

Sustainability report – A report produced by an organisation to inform stakeholders about its policies, programmes and performance in the context of ESG issues. They can be independently audited and integrated into financial reports.

Thematic investing – Funds taking a targeted approach to a specific social or environmental theme, such as water or renewable energy.

Triple bottom line – A framework measuring a company's performance on environmental, social, and economic issues. Companies with this approach aim for profit, along with having a positive effect on the environment and society.

TALK THE TALK

We've outlined some key questions that can help guide the development and monitoring of an ESG framework with asset managers. The key to this approach is developing a consistent framework of dialogue with each asset manager, making it easier in the review process.

KEY QUESTIONS TO ASK WHEN FORMING YOUR ESG APPROACH

1. What do we want to achieve with our ESG approach?
2. What do our members want from our ESG approach?
3. What are our regulatory obligations on ESG?
4. How can we research and inform our ESG objectives?
5. How do we integrate climate-change risk into our portfolio?
6. What are our rules for voting at shareholder resolutions?
7. What do we want to do ourselves/in house?
8. How regularly should we review our ESG beliefs?

KEY QUESTIONS TO HELP YOU WITH DISCUSSIONS YOU HAVE WITH ADVISERS OR IMPLEMENTATION EXPERTS

1. How can we ensure our ESG policy is implemented by all asset managers?
2. How often should we discuss ESG and update policies with our asset managers?
3. How can we independently monitor and manage our ESG policy?
4. Do we have the information we need about the ESG profile of the assets our managers are holding? If not, what can we do about it?

KEY QUESTIONS TO HELP YOU WITH DISCUSSIONS YOU HAVE WITH ASSET MANAGERS

1. How is ESG integrated into your investment process?
2. Do you have a dedicated ESG team?
3. Are you a signatory of the UN PRI?
4. What tools do you use to assess companies' ESG credentials?
5. Which data providers do you use?
6. How have you voted at shareholder resolutions?
7. How do you report on stewardship activities?
8. Do you have any firmwide exclusionary policies?
9. How do you monitor your strategies to ensure exclusion policies are being adhered to?
10. What is your company's own CSR/ESG policy?