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Briefing note

What are your RI beliefs responsible for?

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- A robust approach to RI is not achieved by solely making allocations to ‘green’ manager funds.
- It requires an understanding of your objectives, priorities and beliefs in relation to RI.
- Asset allocations can then be coherently selected to achieve those objectives and meet the beliefs you have.
- To achieve this, we have developed the approach discussed in this note.

When asked if they invest responsibly, most pension fund committees will inevitably respond positively. However, when asked to demonstrate evidence of what Responsible Investment (‘RI’) means for them, how they coherently implement allocations in line with that meaning, and how they know when they have achieved it, answers will often become vaguer, referencing allocations to specific ESG funds or voting policies without clarity of what these are actually expected to achieve.

This is not surprising and reflects a failure across an industry which has provided quick fix solutions to monetise trends without taking the time and energy to step back and understand what RI implementation means, or develop the measures to understand success. This is evident in the growing number of RI investment solutions with numerous ESG indices being available to invest against, but limited guidance as to how to bring these together into a coherent solution.

It’s little wonder that committees can feel overwhelmed by choice and may end up implementing solutions in isolation, without consideration of the wider context or ambition.

Clearer articulation and documentation of the actions committees are taking to address RI and climate issues is becoming more and more critical. This serves not only to address the external scrutiny of press and pressure groups, but also to meet the evolving expectations of industry such as the new Stewardship Code and prospective Scheme Advisory Board Guidance on Responsible Investment, where greater focus is being placed on the outcomes achieved.

So, with this in mind, how do committees and those supporting them avoid a scattergun approach?

Framing an RI policy

To ensure consistency in decision making, any RI policy needs to reference and be framed with respect to the objectives it is aiming to achieve. Objective setting, as with the development of any investment strategy, is a key step for committees. These objectives can be wide ranging, but crucially set the context for consistent future decision making. Examples of typical objectives for an RI policy may be:

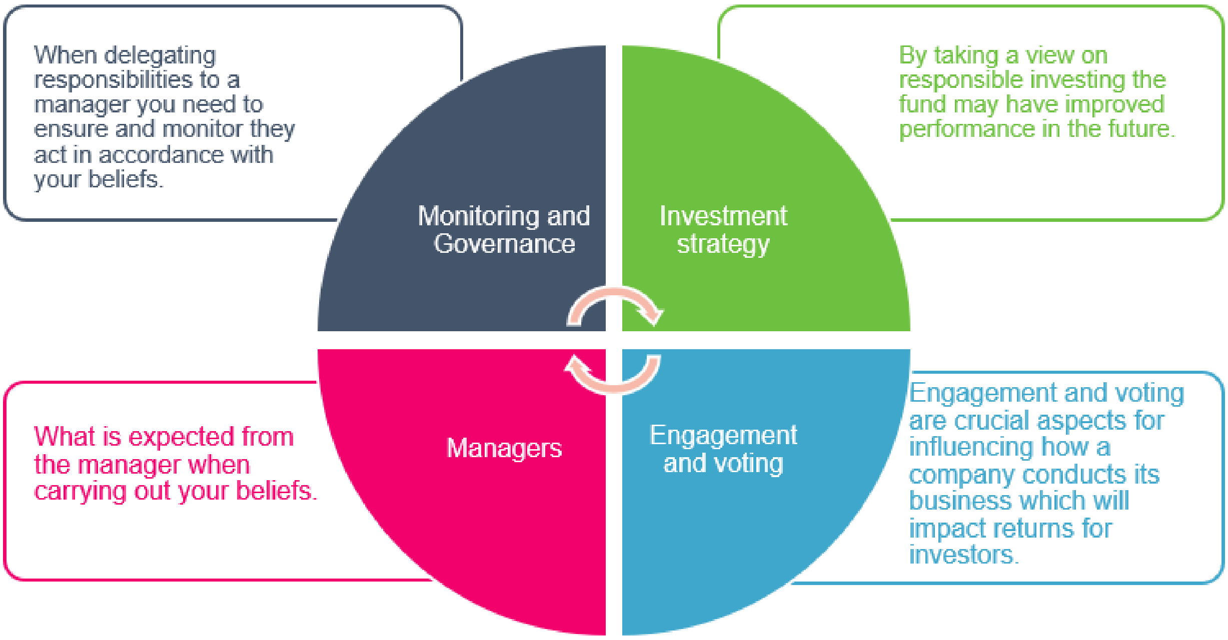
- To support more consistent long-term returns through investing in assets and industries with more sustainable characteristics;

- To achieve lower risk by avoiding stocks with the potential to lose value by causing significant damage to life or the environment; and/or
- To reduce the carbon footprint of the portfolio by x% relative to a baseline level

The chosen objectives should be Fund specific. However, the clear articulation of objectives is both critical in developing the approach to investment but also begins to present metrics and goals against which success can be measured.

Developing and making use of investment beliefs

Once objectives have been agreed, committees must understand what they believe about investment styles and individual assets, particularly with regard to their objectives in order to identify the investment approaches that can be employed. RI beliefs can be split into four broad categories: Strategy, Implementation or Manager Selection, Stewardship and Monitoring and Governance.



Examples of beliefs under each of these categories might be:

Investment strategy: Businesses with more sustainable practices and more effective management of ESG risks should deliver outperformance over the long term.

Stewardship: Engagement with a company is more effective then disinvesting from that company although failed engagement may be a disinvestment signal.

Managers: The key influence an investor has on an active manager is the broad characteristics of the mandate whereas, for a passive mandate, the investor defines the individual stocks held through the choice of index and level and type of engagement.

Monitoring and governance: Challenging managers on their activity can have an influence on outcomes although such engagement must be direct and with purpose to deliver success.

Beliefs can be developed in many ways. Some may infer beliefs through their existing practices and processes whilst others may step back and repose the fundamental questions of their investment approach. Either way, dialogue among decision makers is essential to arrive at a collective set of beliefs and, where possible, beliefs should be supported by evidence. By adopting this structured approach, committees can identify approaches to investment that they expect to deliver their RI objectives.

Developing priorities

In addition to objectives and beliefs, an RI policy should identify its priorities, recognising both that change takes time and committees have a limited governance budget. Our experience is that priorities will be somewhat informed by the goals of the Local Authorities themselves and could encompass issues such as climate change, workforce practices, company stewardship and anti-social activities (e.g. controversial weapons).

Each of these issues can be addressed in different ways. For example, climate change can be addressed through changing strategy, changing managers or changing the behaviour of investee companies through engagement. Committees can combine the consideration of their objectives, priorities and beliefs to create a clear focus on the actions that may be taken over both the short and long term in order to evolve their approach to RI and their investment actions.

Importantly however, these actions are driven by the informed decisions of the committee, thereby enabling the committee members to address the question of what being a responsible investor means to them.

Pulling these strands together

By identifying clear goals to be achieved by the RI policy, beliefs around investment approaches and assets; and priority areas to address, a clear and coherent approach to RI can be developed by the committee. This can, in turn, be used to cut through the varied approaches to RI investment that the industry has developed, enabling committees to identify suitable strategies and demonstrate to their stakeholders and external bodies the robustness of the considerations undertaken and approach adopted.

Case study: Putting this into practice

Key requirement:

Bedfordshire Pension Fund Committee required a clearly articulated and coherent RI beliefs statement and policy both to set its own internal approach to responsible investing but also to test the RI approach taken by BCPP, its pooling provider.

What we did:

- Led the Committee in a training session to understand the many aspects of RI, the importance of many of the considerations and the tangible value it can add to sustainability of investment outcomes.
- Took the Committee, Officers and key stakeholders through a questionnaire to assess their understanding of issues and views on beliefs and priorities.
- Led a workshop to highlight the wide range of views across the Committee and stakeholders to find common ground and alignment within those views to develop a single set of agreed Committee beliefs. The Committee are currently in the process of using that set of beliefs as a basis to:
    - Comment on the BCPP RI policy and consider how the two are aligned;
    - Review their own approach to the structure of the equity portfolio to align it with their approach to RI (and will be reviewing other portfolios in the near future).
    - Assess different investment opportunities, and
    - Respond to member and press queries to highlight the process that has been employed and convey the importance of the subject to Bedford whilst also recognising that change takes time.

Benefits to Bedfordshire:

The result was a set of RI beliefs and objectives which were used to establish a consistently implemented formal policy that can be easily integrated with the wider strategic approach to investment, without impacting the over-arching objective of delivering the investment returns required to pay benefits to members.

The Committee is now well placed to make and monitor the RI implications of future investment decisions. It has a clear point of reference against which it can assess the success or otherwise of its decisions and can respond quickly and robustly to member and press queries on the approach taken.

If you would like to examine this approach in more detail or discuss how it could be applied to your Fund, please get in touch with your usual Hymans Robertson consultant.