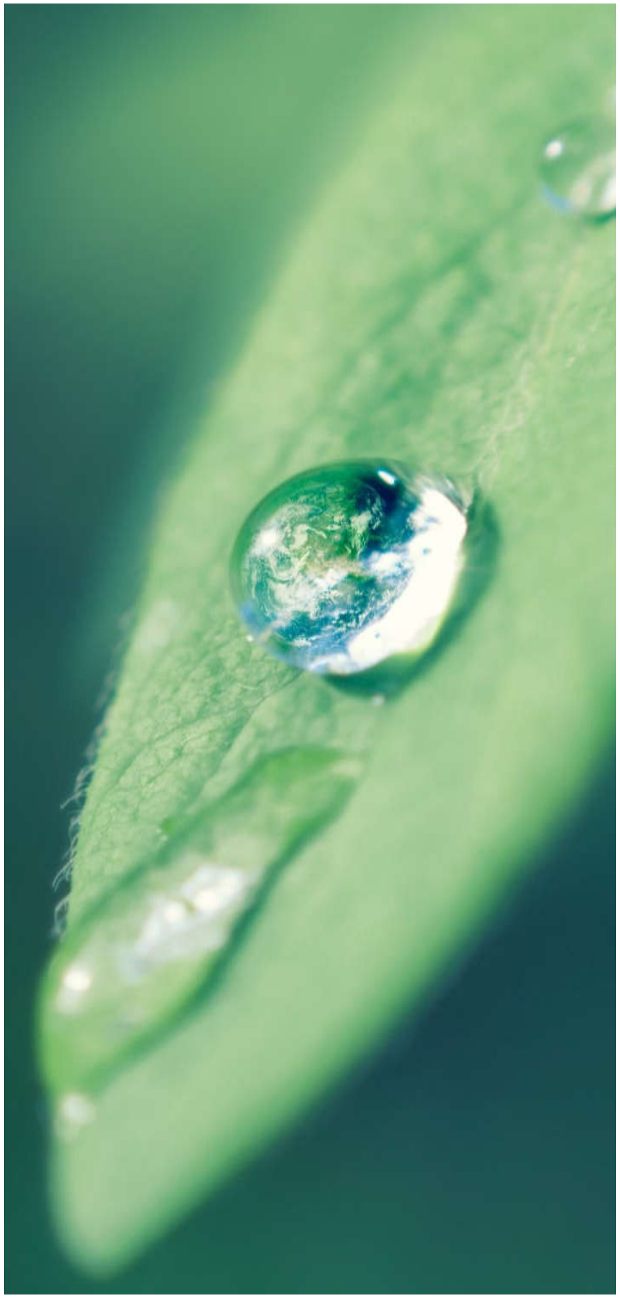
Environmental, Social and Governance Factors

Trustees' Investment Duties

Mark Solomon



Agenda

1	What are ESG factors?
2	Why are we talking about ESG now?
3	Trustees' investment duties
4	Legislative changes
5	What next?

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What are ESG Factors?

- Investing which takes into account financial risks posed by environmental, social and governance factors. Examples include:

Environmental

- Climate risk
- Pollution
- Sustainability

Social

- Diversity
- Equal opportunities
- Working conditions

Governance

- Management diversity and structure
- Executive compensation
- Business ethics

Why are we talking about ESG now?

- ESG investing: the temperature is rising
  - Pensions Expert (30 October 2018)
- Pension funds fail to insulate against climate-change risks
  - Financial Times (4 November 2018)
- Markets as mirrors: Millennials and the growth of sustainable investing
  - Investment Week (12 February 2019)
- ESG: The changing climate of investment advice
  - Funds Europe (March 2019)
- Norway's $1 trillion fund to cut oil and gas investments
  - BBC News (8 March 2019)
- L&G master trust default goes green due to member demand
  - Pensions Expert (13 March 2019)
- Ethical revolution is inescapable
  - The Times (13 March 2019)

Why are we talking about ESG now?

Legislative developments

Increase in member interest

Acknowledgment that ESG factors have financial and not just ethical implications

Investment industry

Trustees' investment duties

- In selecting an investment the trustee should take such care as an ordinary prudent man would take in making an investment for the benefit of other people for whom he felt morally bound to provide (Re Whiteley (1886))
- Cowan v Scargill
  - investment in line with NUM policy not a legitimate basis to discharge fiduciary duty to act in members' best interests
  - risk of conflating ethical with ESG factors
- 2014 Law Commission Report
  - invest in best interests of members
  - no requirement to maximise returns
  - distinguish between non-financial ethical factors and financial ESG factors related to risks, returns and sustainability.
- Statutory powers:
  - Sections 33-36 PA 1995
  - Investment Regulations 2005

Legislative changes

- December 2016: IORP II - member states shall allow schemes to take into account the potential long-term impact of investment decisions on ESG factors
- June 2018 consultation on ESG legisation: "to dispel trustee confusion, and give institutional investors renewed confidence, if they so choose, to begin or increase the allocation of capital to investment opportunities such as unlisted firms, green finance and social impact investment"
- The Pension Protection Fund (Pensionable Service) and Occupational Pension Schemes (Investment and Disclosure Regulations) 2018.
- Statement of Investment Principles to set out:
  - policies towards "financially material considerations", which will include "environmental, social and governance considerations (including climate change)" over "appropriate time horizon"
  - policies on stewardship, including the exercise of rights attaching to investments and engagement with firms
  - extent, if at all, non-financial matters are taken into account
- Proposal requiring Trustees to prepare a statement on how they will take into account members' views about financial and non-financial matters was dropped.

Legislative changes

- Additional disclosure requirements trustees of "relevant schemes" (broadly occupational schemes offering DC benefits in addition to AVCs):
  - publish SIP on public website
  - schemes with 100 or more members to state policy in relation to stewardship of investments in default investment strategy
  - produce and publish an implementation report
- Timetable
  - 1 October 2019 – SIP to be updated; publication of SIP on public website; policy on stewardship in default investment strategy
  - 1 October 2020 - implementation report
- Occupational Pension Schemes (Governance) (Amendment) Regulations 2018
  - establishment and operation of an “effective system of governance” (which considers ESG factors and assesses new or emerging risks (including climate change)

What next?

- ESG cannot be ignored
- Trustees need to take concrete action prior to 1 October 2019 as SIP will need to be updated
- Steps by Trustees should include:
  - consideration of ESG factors and how to integrate them into investment approach
  - discussions with investment consultants on ESG and stewardship policy
  - consultation with sponsoring company on any update to SIP
  - for "relevant schemes", review of default investment strategy, ensuring that the SIP is made available on a public website and further down line production of implementation report

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