

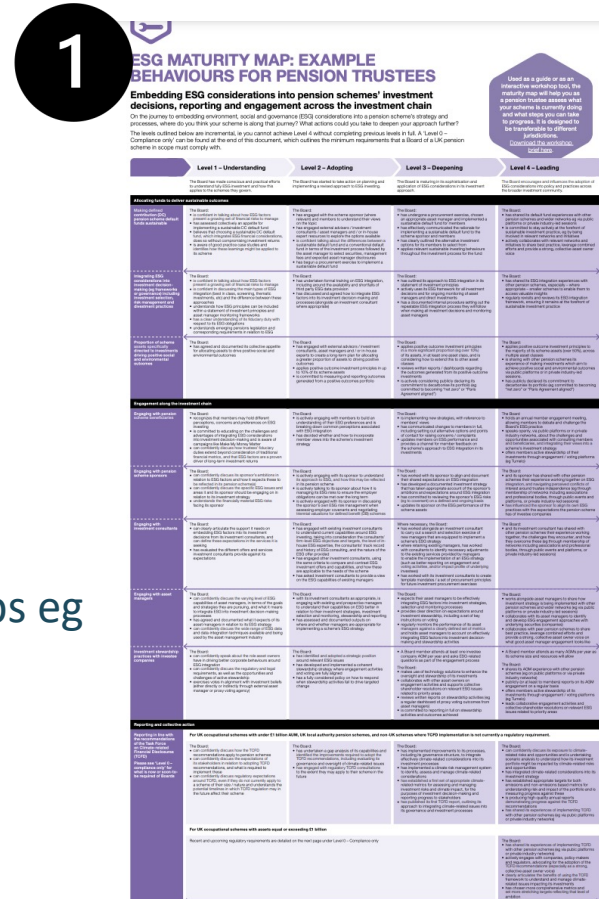
ESG TOOLKIT FOR PENSION CHAIRS AND TRUSTEES BEYOND COMPLIANCE



WHAT IS THE ESG TOOLKIT FOR PENSION CHAIRS AND TRUSTEES?

A toolkit of resources consisting of:

1. An **ESG maturity map** with suggested steps that schemes can take to progress on their ESG integration journey.
2. **Practical examples** of pension schemes to bring 'what good looks like' to life.
3. **Guidance material** to highlight the practical steps eg embedding ESG factors into different asset class portfolios.



WHAT DOES THE TOOLKIT SEEK TO ACHIEVE?

- To support chairs and trustees of pension schemes identify the practical steps to embedding ESG considerations into their investment decisions, reporting, and engagement across the investment chain.
- To support trustees in their discussions with fellow trustees, consultants and fund managers, about actions they should take.
- To be transferable to different jurisdictions where appropriate.

"It is often hard to navigate through the plethora of information to pick out the key practical steps that pension scheme trustees should take to integrate ESG considerations into their investment strategy and processes. A4S's ESG Toolkit for Pension Chairs and Trustees has been specifically written for trustees in mind, to help them with this challenge and support our discussions with fellow trustees and our members"

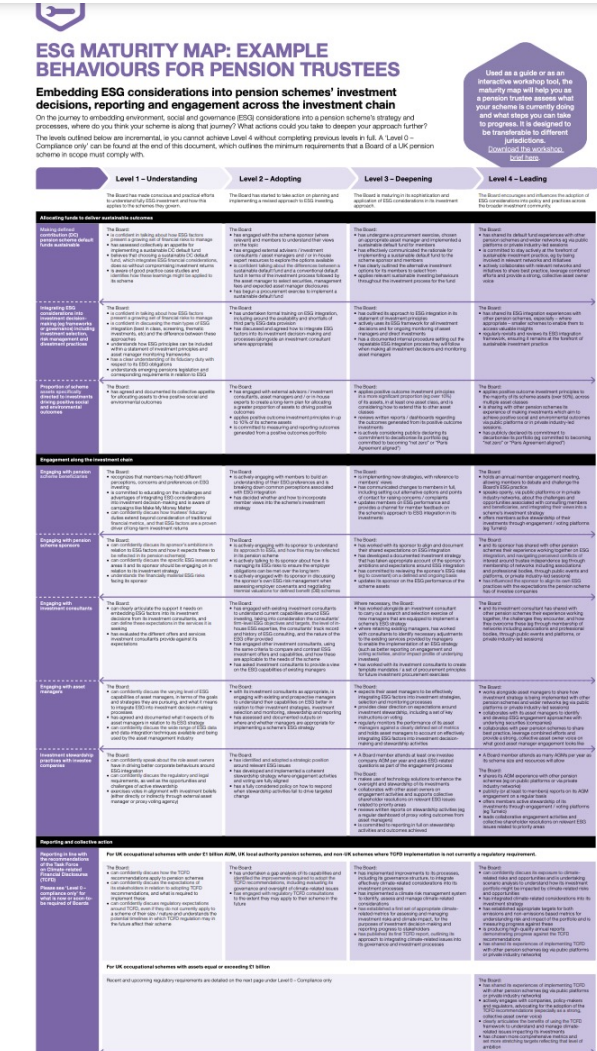
Russell Picot, Chair of the HSBC Bank (UK) Pension Scheme and Co-Chair of A4S's Asset Owners Network

"The events of 2020 have reminded everyone that we live in an uncertain world. The impacts of climate change on infrastructure, like floods and subsidence, create risks for investors. Portfolio managers need to quantify and plan for physical risk to achieve steady long-term returns, but, in the short-term, this work will also connect your pension funds with the public who increasingly demand action on the climate emergency. A4S's ESG Toolkit for Pension Chairs and Trustees will help you navigate through a changing landscape."

Emma Howard Boyd, Chair of the Environment Agency, and Co-Chair of A4S's Asset Owners Network



ESG MATURITY MAP (1/2)



This maturity map outlines ‘what good looks like’ embedding ESG considerations into trustees’ investment decisions, reporting, and engagement across the investment chain. This is set out across four levels of maturity:

Level 1 – Understanding
Level 2 – Adopting

Level 3 – Deepening
Level 4 – Leading

Used as a guide or as an interactive workshop tool, the maturity map can help pension trustees assess what their scheme is currently doing and what steps they can take to progress.

For example, for investment stewardship activities with investee companies:

- At Level 1, a Board could confidently speak about the role of asset owners in driving better corporate behaviour around ESG integration.
- At Level 3, a Board member would be expected to attend at least one investee company AGM per year, asking ESG-related questions as part of the engagement process.

ESG MATURITY MAP (2/2)

Level 0 – compliance only.

This table sets out the minimum requirements that a UK pension scheme must currently comply with or needs to start processes in order to comply with near-term regulations as set out in the UK Pension Schemes Act 2021.

Requirement – The Board must:	Deadline	Type of scheme
Include ESG and stewardship policies in its Statement of Investment Principles (SIP) and publish this online.	By 1st October 2020 (if not earlier)	DB and DC / Hybrid
Publish 'implementation statements' explaining how it has implemented its SIP policies, including in ESG and stewardship, as well as provide further information on its asset manager and investment engagements.	First annual report from 1st October 2020 and no later than 1st October 2021	DC / Hybrid
Include a description of the voting behaviour by or on behalf of the trustees including the use of proxies within the published Implementation Statement.	By 1st October 2021	DC / Hybrid
Publish an Implementation Statement explaining how it has implemented its SIP policies, including policies around voting and stewardship.	First annual report from 1st October 2020 and no later than 1st October 2021	DB
Following the coming into force of the Occupational Pension Schemes (Climate Change Governance and Reporting) Regulations 2021 on 1 October 2021, the Board in scope must:		
Disclose – within its governance policies – how it maintains oversight of climate-related risks and opportunities which are relevant to the scheme; as well as the role of any person who undertakes governance activities, or who advises or assists the Board with respect to governance (excluding legal advisers), in identifying, assessing and managing climate-related risks and opportunities – and the process by which the Board satisfies itself that the person is undertaking such identification, assessment and management.	From 1st October 2021, with the scheme's first annual TCFD report produced and published within seven months of the end of the scheme year underway on 1st October 2021 - Occupational pension schemes with assets under management (AUM) of more than £5 billion, authorised master trusts and collective money purchase schemes. From October 2022, on the same basis – Occupational pension schemes with AUM of more than £1 billion.	
Identify and then assess the impact of climate-related risks and opportunities which it considers will have an effect over the short term, medium term and long term on the scheme's investment strategy and, where relevant, the funding strategy.		
Undertake – as far as it is able – scenario analysis using at least two scenarios where there is an increase in the global average temperature, (one of which is with an average temperature rise of between 1.5°C and 2°C above pre-industrial levels); and then disclose the results.		
Disclose in a publicly available report, effective processes to identify, assess and manage climate-related risks, and ensure that this is integrated into the Board's overall risk management of the scheme.		
Select, use and disclose at least two emissions-based metrics and one additional climate-related metric to calculate in relation to the scheme's assets.		
Set a target for the scheme in relation to at least one of its chosen metrics and report annually on progress against the target.		
Have knowledge and understanding of the principles relating to the identification, assessment and management of risks and opportunities to its scheme arising from the effects of climate change; and implement trustee training where needed.		
Possible developments after the Pension Schemes Act 2021		
In the future, the Board may need to oversee the publication of the contribution of schemes' assets to climate change (the "implied temperature rise" of the scheme).		
In the future, the Board may also need to disclose what percentage of its pension scheme activities are "green", in line with a UK taxonomy.		

Following consultation with trustees and chairs, Level 0 has been added, outlining the minimum requirements that a UK pension scheme must currently, or needs to start processes in order to, comply with near-term regulations as set out in the UK Pension Schemes Act 2021.

A MATURITY MAP WORKSHOP

A4S has written an accompanying guide to help trustees ‘workshop’ the maturity map with their Board. Previous participants have said how this workshop process has helped drive consensus across the Board on where their priorities should be and what next steps they will focus on. Some schemes have also brought their fund managers and Exec team to the process.

Key features of the workshop guide:

- Suggests participants, a step-by-step activity format and tips for maximizing engagement in a virtual context.
- An outputs template to record consensus on level of maturity per area, challenges identified and agreed next steps.
- Resource links table to signpost you to peer-case studies and guidance material.
- A commitments table to commit to progress with milestones and definitions of success.

Appendix 3 – resource links to date (within the A4S ESG Toolkit for Pension Chairs and Trustees)

Action area	A4S - Case study examples	A4S - Guidance material	External resources
Sustainable default funds	NEST		IIGCC + PAII - Net Zero Investment Framework 1.5°C Implementation Guide
Proportion of scheme assets invested to drive ESG outcomes	Environment Agency Pension Fund		Impact Investing Institute and Pensions for Purpose - Impact Investing Principles for Pensions
Integrating ESG into investment decision-making (frameworks and governance)		Embedding ESG into different asset classes	CFA Asset Owner Summit SDG-ESG Infrastructure Investment Framework
Engaging with beneficiaries	Tesco Pension Fund	Top Tips for Sponsors of Pension Schemes	Cambridge Institute for Sustainability leadership - Walking the talk: Understanding consumer demand for sustainable investing
Engaging with sponsors		Top Tips for Sponsors of Pension Schemes	
Engaging with consultants			Investment Consultants Sustainability Working Group - Guide for assessing climate competency of Investment Consultants
Engaging with asset managers	BT Pension Scheme		PLSA - Engaging the Engagers - A practical toolkit for schemes to achieve effective stewardship through their managers PRI - Investment Manager Monitoring Guide
Stewardship	The Church of England Pensions Board		FRC - The UK Stewardship Code 2020 - Review of early reporting PLSA - Stewardship Guide and Voting Guidelines 2020 UNPRI - A Practical Guide to Active Ownership in Listed Equity
TCFD reporting	BBC Pension Scheme HSBC Bank (UK) Pension Scheme West Midlands Pension Fund	Top Tips for Finance Teams on implementing the TCFD recommendations	DWP - Aligning your pension scheme with the Taskforce on Climate-Related Financial Disclosures recommendations

Appendix 4 – commitments table

A key output of the maturity map workshop will be to establish specific commitments for your pension scheme. We recommend that your commitments are ambitious annual basis.

Commitment	Milestones	What will success look like?
What do you want to achieve this year? What priority area (left hand column of maturity map) does it relate to?	How can we measure progress?	Provide details of what successful achievement of this commitment would look like? Eg moving from Level X on maturity map to Level X.

PRACTICAL EXAMPLES

Access the bank of practical examples [here](#)

These practical examples, written 'in the voice' of pension schemes, are designed to enable trustees understand the 'what', 'why' and 'how' on different elements of ESG integration.

They focus on the practical steps that trustees can take and include 'top tips' on taking similar action.



A4S
ASSET OWNERS
NETWORK

DELIVERING A NET ZERO
INVESTMENT STRATEGY

Practical example: National Employment Savings Trust (NEST)




WHAT

Nest Corporation is the trustee for the UK's biggest pension fund by members, National Employment Savings Trust (NEST). This pension scheme was created as part of the UK government's automatic enrolment reforms for workplace pensions.

In July 2020, we announced a new climate change policy, which sets out our ambition to align our entire investment strategy with limiting global warming to 1.5°C. To achieve this, we expect to halve our greenhouse gas emissions by 2030 and reach net zero greenhouse gas emissions by 2050 at the latest.

We have made specific commitments to achieve this in the following areas of:

- Asset allocation
- Fund manager selection and monitoring
- Stewardship
- Public policy

An immediate step was to reallocate developed market equity allocation in the fund to climate aware strategies - now £5.5 billion of members' money. Our aware fund positively tilts towards companies mitigating and adapting to climate change as those producing renewable energy, green technology and those with strong reduction plans in place. This move represents 45 per cent of our entire portfolio and has an immediate effect on the default funds. More than 9 million of our members rely on these funds.

Practical example: National Employment Savings Trust (NEST)

NEXT STEPS

One challenge for us is tracking our progress towards the methodology should align with our 1.5°C pathway across all asset classes. It's an area that we're still working on.

Building on our work in developed equity, we would like to take a similar approach with emerging market equity. We want to make sure that underlying investments for this asset class are also on the right path for creating a 1.5°C world. The data here is not as strong, though. After examining the quality of the data, we will decide whether and how to adapt our approach.

We would like to create space for a two-way dialogue with our members and are exploring fintech solutions. At the moment, we are mostly informing members what we're doing. Member feedback could help us to prioritize where we commit our resources. It could even improve our engagement with companies, by showing that our vote represents the views of a large number of members who cared enough to express a preference.

Practical example: National Employment Savings Trust (NEST)

TOP TIPS

SET OUT YOUR INTENT

Be clear about your goals and what you want to achieve. You don't have to know how you're going to deliver on every aspect. We found it helpful to set out our intentions publicly so that we had something to start working towards.

CHECK THE NUMBERS

It's vital to be evidence-based when you are making decisions about sustainable investing and pension funds. Make sure that you have good numbers and strong evidence. This will help you to demonstrate the rationale for what you're doing and to follow through in a meaningful way.

CHOOSE THE RIGHT FUND MANAGERS

Having the right team of fund managers makes a huge difference. Help them to understand why thinking about climate change risk and other ESG factors is important. We've found that our fund managers have been very open to these ideas, but they needed the right push from their clients.

SPEAK TO YOUR SAVERS

Communicating with members about sustainability will become increasingly crucial for pension funds. Input from savers is also a way to develop a stronger licence to operate.

BE AN ACTIVE SHAREHOLDER

By engaging with the companies that you've invested in, you can use your influence to bring about real change. It also makes a difference to talk about being an active shareholder. Talking openly about your experience and collaborating can encourage others in the industry to take a similar approach.

Practical example: National Employment Savings Trust (NEST)

able to achieve the right long-term risk-adjusted returns.

Every scheme should carefully consider the risk climate change poses to their funds and what their options are. Different portfolios will face different challenges, so it's important we share information to help schemes make the right decisions.

Taking the first step is important. You don't need to have every detail mapped out - setting your commitments and intentions in relation to tackling climate change can get you on the right path."

CHRIS HITCHEN,
CHAIR OF NEST'S INVESTMENT COMMITTEE

CASE STUDY - TESCO



ALIGNING OUR MEMBER
EXPECTATIONS WITH OUR
INVESTMENT STRATEGIES

Practical example: Tesco Pension Fund



CASE STUDY - BBC



OUR APPROACH TO SCENARIO ANALYSIS

Practical example: BBC Pension Trust



GUIDANCE MATERIAL

We are building a bank of resources designed for chairs and trustees on different elements to integrating ESG into their investment decision-making and processes.

The different resources aim to help facilitate discussions in-house and across the scheme's investment chain, highlighting key actions and steps that can be taken.



EMBEDDING ESG FACTORS INTO FIXED INCOME INVESTMENTS

A summary guide for pension trustees

Fixed income is a diverse asset class that can serve a range of purposes in pension scheme portfolios. Investment-grade sovereign and corporate bonds offer a source of relatively stable, contractual cash flows, and do not typically exhibit the volatility inherent in global equity markets. Long-dated bonds also play a key role in matching long-term liabilities for a range of institutional investors. There are also higher risk and return options, including high-yield debt securities issued by organizations or countries with low credit. These securities can offer attractive ongoing returns to compensate for the higher risk of default, and investors would benefit from improved credit ratings in the future.

For corporate ESG issues, in the short, it and avoid debt increasingly credit ratings credit analysis holistic under to default.

Pension schemes consider a range of these when income investment factors, how they can achieve their ability to

When it comes with issuers' ownership rights the marketing engage with them and ESG-related

Within fixed support spec bonds and designed to benefits, however way to achieve fixed income

In the context of government debt, the importance of assessing governance risk factors such as political stability, institutional strength and the rule of law, is well recognized. In parallel, however, environmental risk factors, such as climate disasters, energy and food security are increasingly seen as influencing economic factors such as tax revenues and a government's ability to attract foreign investment. ESG factors, in impacting a country's economy, can also influence underlying inflation and interest rates – core metrics to consider when assessing the potential interest rate risk of any bond investment.

ESG maturity map

The A4S ESG maturity map, part of its [ESG Toolkit for Pension Chairs and Trustees](#), sets out example behaviours for integrating ESG into fixed income investment decision making. At the beginning of a pension scheme's journey, trustees might seek to

Level	Understanding
Level 1	Example behaviours The Board: - can confidently discuss the role that ESG can play in determining credit ratings, defaults and bond pricing (from the perspective of both corporate and sovereign debt), and how this can have a significant influence over future pension values and ability to pay long-term retirement income beneficiaries - can confidently discuss the types of engagement it can have with companies whose debt it owns (especially where it has large debt holdings), despite not having ownership rights - can confidently discuss the different approaches asset managers can take to integrate ESG factors into debt investing, and that investing in sustainability-linked bonds – eg green bonds, sustainability bonds, etc – is only one avenue of incorporating ESG considerations into debt investments - has considered and documented how it will integrate ESG into debt investment decisions and risk management practices, particularly on credit ratings, defaults and bond pricing
Level 3	Deepening The Board: - has implemented a framework for integrating ESG factors into debt investments, covering both direct and / or fund-level investing by external managers - has tested an approach to engagement around ESG issues for investments made by external managers - has a process for continual assessment of external managers' ESG investment capabilities in corporate and sovereign debt through regular reporting against a clearly defined set of metrics - has considered and implemented or documented reasons for not implementing the procurement of green, social or sustainability bonds as part of its asset mix - uses the influence and rights as a debtholder to engage with company management on ESG issues

Practical actions that trustees can take

Area	Action
Education	- Arrange for all trustees to be educated about the ESG risks and opportunities associated with investing in fixed income, including: - How ESG factors affect credit ratings, interest rate risk and defaults, and therefore bond yields and pricing; - The different factors within ESG that impact corporate and sovereign fixed income; - The opportunities associated with investing in sustainability-linked bonds, and how these can be integrated into the scheme's asset mix.
External manager expectations	- Ensure there is a consistent approach to assessing new and existing external managers on capabilities around fixed income ESG investing, by examining: - Quality of ESG-related research across both corporate and sovereign fixed income investing; - Quality of annual disclosures to UN Principles of Responsible Investing on fixed income investing; - ESG strategies currently used across fixed income offer; - Use of ESG analysis and data by fixed income portfolio managers; - Whether the manager uses engagement as a tool to achieve desired outcomes in its fixed income investing.
Direct fixed income investing	- Oversee the development of a framework for embedding ESG factors into the direct fixed income investment process, covering sovereign, investment-grade and high-yield corporate debt. - Work with credit rating agencies and ESG data providers to identify data and analysis that can be incorporated into fixed income yield and price analysis. - Establish whether the scheme could and should invest in bonds which aim to achieve positive environmental and social outcomes, such as green bonds.
Engagement	- Include fixed income in the scheme's overall approach to stewardship. - Use the influence and rights as a debtholder to engage with company management on ESG issues (especially at both issuance and reissuance points when engaged investors can impact pricing and the inclusion of specific ESG-related covenants). - Work with external managers to ensure any externally managed fixed income portfolios are aligned with the scheme's overall strategy.
Collective action	- Collaborate with other large debtholders, as well as aligning engagement goals with equity investors, to increase influence and persuade companies to take action on relevant and material ESG issues. - Collaborate with other pension schemes to articulate market demand for green or sustainable government bond issuance.
Measurement and reporting	- Actively explore ways for the scheme to generate ESG metrics from the real estate portfolio, such as: - Social metrics – people employed through construction, social tenants housed and social businesses provided with commercial / office space; - Environmental metrics – including carbon emissions, trees planted and water recycled.

This summary guide for pension trustees is part of an [ESG Toolkit for Pension Chairs and Trustees](#) by The Prince's Accounting for Sustainability Project.



SUSTAINABLE INVESTING IN PENSIONS

TOP TIPS FOR SPONSORS OF PENSION SCHEMES



THE PENSION LANDSCAPE

The importance of sustainable investing continues to grow in the UK pensions landscape. Regulatory policy has acknowledged the financially material impacts of environmental, social and governance (ESG) factors on investment decisions: defined benefit (DB) and defined contribution (DC) pension scheme consolidation is changing the size and shape of assets under management; and there is some evidence of a growing demand from members, enabled by increased reporting and online technology (dashboards, apps, etc), for investments to reflect their values.

In spite of the shock that the COVID-19 pandemic has delivered to the global economy, with both pension schemes and sponsors adjusting to the crisis, the focus on sustainable investing has not dissipated. The pandemic highlighted the fragility of the financial assumptions on which we rely to invest and secure our employees' wellbeing in retirement, reinforcing the need for effective risk management, governance and a long-term outlook.

The pandemic has demonstrated just how rapidly nature can impact society and the economy. For many this has reinforced the urgency of the response needed to avert the climate crisis, an even greater existential threat that needs to be addressed if individuals – your employees – are going to retire into a thriving society on a healthy planet. In managing this threat, we must take on board the lessons learnt from COVID-19 on preparedness and long-term planning.

TIPS ON ENGAGING YOUR MEMBERS

- It is very much a two-way process**
If we raise expectations then we need to follow this up and do something with the answers that members give us.
- Go digital**
All our member engagement is now online which has allowed us to generate member surveys relatively easily, quickly and cheaply with a large part of our membership.
- Break the response data down**
Across different demographics and membership type to be able to tailor future correspondence accordingly.
- Use relatable language**
Break down 'ESG' into the language and issues your members are reading and talking about.
- Use communication experts to help frame and order questions**
As non-experts in this field it's easy to set leading questions inadvertently.
- Plan for the responses**
Successful member engagement will generate interest and more queries so make sure you have enough resources in place to meet the demand.
- Bring members' money alive!**
Use case studies to show where members' money is invested and the types of impact it is making.
- Signpost members to relevant information and education campaigns**
So members can learn more about these issues and what it might mean for their own financial planning.

Robert Gould, Chair of the Environment Agency Pension Fund

RECENTLY LAUNCHED – NET ZERO GUIDANCE

- Aligning to a net zero pathway: [guidance](#) and [practical examples](#) for pension trustees
- Achieving net zero – [practical guidance for finance teams](#)

Tell us what resources and practical examples you would like to see – Kerry.Perkins@a4s.org

SUGGESTED NEAR-TERM ACTIONS

1. Read through the toolkit – including the maturity map and the net zero resources launched on Friday.
2. Encourage your trustee clients to schedule an ESG Maturity Map workshop session
3. Once priority areas have been agreed, encourage your trustee clients to engage peers, and read relevant case studies or guides. We can signpost you to relevant examples.
4. Suggest Chairs to join our Asset Owners Network – email Kerry.Perkins@a4s.org



A4S ACCOUNTING FOR SUSTAINABILITY



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The Prince's Accounting for Sustainability Project (A4S)



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www.accountingforsustainability.org/pensions-toolkit



The A4S Asset Owners Network is a grouping of pension fund chairs and trustees to discuss integrating sustainability into investment decision making. [Click here to find out more.](#)