Breaking through the ESG barrier

May 2019
Breaking through your ESG barrier

Pension schemes and fiduciary management

The average pension scheme trustee and their company sponsor are not doing enough about responsible investment. KPMG’s 2018 Fiduciary Management Survey found that 58% of all UK Defined Benefit pension schemes had engaged with their Fiduciary manager on Environment Social & Governance (‘ESG’) issues over the last 12 months (to 30 June 2018). However, the vast majority of engagement over that period was ‘light touch’.

Moreover, the lines of responsibility are somewhat blurry when decisions are delegated by a trustee to an FM. ESG, as an investment theme is an increasingly topical issue and we think more can be done by both trustees and their FMs to improve engagement. This paper sets out a guide to break down the ‘ESG barrier’ and engage with your FM today.

What does ESG mean?

‘ESG’ addresses the responsibility of institutions and individuals to the world they live in. E, S and G broadly stand for the following:

— Environmental: How an investee acts as a steward of the natural environment.
— Social: How a company manages relationships with employees, suppliers, customers, communities etc.
— Governance: Looks at company leadership, executive pay, internal controls, external audits and shareholder rights.

What is Fiduciary Management?

Fiduciary management is where trustees delegate some or all investment decisions to a third party:

— This includes, but not limited to, setting strategic and tactical asset allocation, selecting investment managers, and ongoing performance monitoring.
— On average, the number of pension schemes using FM has increased by 31% per annum over the past ten years (according to KPMG’s 2018 Fiduciary Management Survey).

Are ESG and FM compatible?

There is no reason why ESG and FM can’t be compatible:

— Trustees may be under the impression that because decisions are delegated to an FM, or your policy is to delegate ESG decision making to your FM, they do not have an ESG policy or responsibility. This is incorrect – In this case your policy is effectively that of your FM, and it is your responsibility to be familiar with your FM’s policy to ensure they are managing these risks appropriately.
— Many FMs recognise their responsibility by implementing baseline policies. These address the FM’s core beliefs, but do not necessarily align with the beliefs of the trustees or sponsor.
— The market is sophisticated enough to accommodate a significant number of fiduciary offerings for pension schemes with enough variation in service and cost to implement bespoke ESG policies.

We believe the key is in finding out exactly what your FM is doing, and whether the FM’s philosophy process and actions align with views of trustees.
The ‘ESG barrier’ is a perceived obstacle preventing engagement between trustees and their FM. The diagram below shows a typical fully delegated FM governance structure.

**Investment managers**

- **A**
- **B**
- **C**
- **D**
- **E**

Without engagement by the trustees, the FM tends to implement their own ESG policies and processes. We think this is sub-optimal. How can trustees and sponsors ensure their FM is acting in line with expectations?

Below we present a step-by-step approach to overcoming this ESG barrier. This can be used by trustees and sponsors as a guide for your next discussion with your FM (we note some or all of these steps may have taken place already).

**01**

Do you have a formally agreed ESG policy?

If Not:
Add to your next meeting agenda, agree and formalise a policy in your Statement of Investment Principles.

**02**

Do you know what your FM is doing with regards to E,S, or G?

If Not:
Engage with your fiduciary manager. What are their policies and how do they impact your mandate?

**03**

Does your policy align with what your FM is currently doing?

If Not:
Ask your FM how they can incorporate your policy and the implications (e.g. cost).

**04**

Can you make changes to your mandate without significant restrictions?

If Not:
Consider switching to a provider that aligns with your ESG policy.
How can KPMG help you

01 Truly independent
KPMG does not and will not offer FM services. An experienced independent third party can bring clarity to discussions.

02 Understanding the market
We understand how FM work and the full range of options available, as evidenced by our ongoing research and annual FM survey.

03 Thought leadership
We are a market leader in thought leadership, publishing papers on topics such as equity, credit and real assets, ESG, and actuarial/insurance.

ESG is becoming increasingly more topical, and future regulation may require trustees and sponsors to act today. The DWP recently undertook a consultation to revise current regulations surrounding Pension Scheme Trustees’ fiduciary duty, including additional statutory disclosure requirements within the SIP, with particular emphasis on ESG related issues, such as climate change. KPMG can assist trustees in understanding ESG, agreeing a policy, and getting the most out of your fiduciary mandate over time. We provide some example services below and would be happy to discuss this with you in more detail.

Training on ESG and FM
An initial step to help trustees understand the concepts, manage risk, identify opportunities and mediate discussions on setting an ESG policy.

Independent monitoring
From reviewing guideline documentation to conducting feasibility studies based on a defined ESG policy.

Review FM capabilities
Provide an ongoing monitoring of your fiduciary mandate. This can include reviews of return and risk, as well as your ESG policy, monitoring how this is implemented.

Understanding the FM market
Insight into the UK market, how each provider differs, and the implications of implementing your ESG policy.
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