Retirement News Highlights

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Greater adoption of ESG linked to acceptance as fiduciary duty

Institutions behind push to move practice into mainstream of investing

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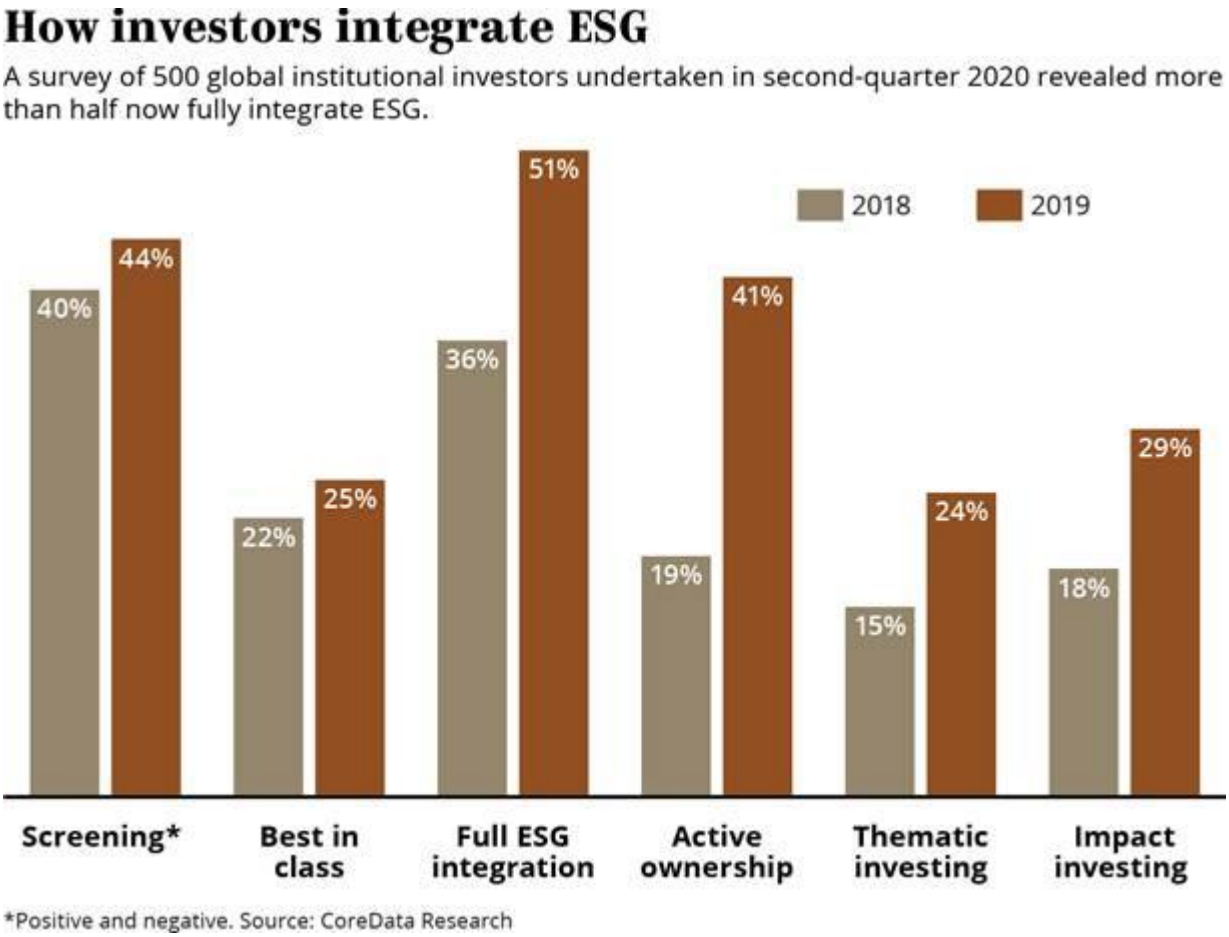
ESG investing is reaching an inflection point, as the risks and opportunities — and the responsibility to deal with them — gets harder for pension funds and other institutional asset owners to ignore.

"They own the market and they are long-term investors, so they have to be more aware," said Michael Jantzi, Toronto-based CEO of Sustainalytics, a global provider of ESG data and ratings. In North America, ESG investing "is a much more mainstream phenomenon than it used to be, and it's largely driven by institutional investors. When we are talking to CIOs, increasingly in this part of the world, they say, 'of course we look at it.' That's not radical to say anymore," said Mr. Jantzi, who credits some of the change to growing acceptance of ESG investing as a fiduciary duty.

The evolution means that ESG investment decisions are more fully integrated across portfolios and all asset classes. A survey of 500 global institutional investors in the second quarter of 2020 from CoreData Pty. Ltd. found that 51% now fully integrate ESG into their investment approach, compared with 36% just two quarters earlier. Active ownership strategies to engage companies on ESG issues more than doubled to 41% from 19%. The investors included pension funds, endowments and foundations, sovereign wealth funds and banks.



When it comes to integrating ESG into portfolios, officials at the $194.3 billion New York State Common Retirement Fund, Albany, leave little to chance. Their sustainable investments and climate solutions program has a $20 billion commitment to sustainable investments, with dedicated staff and minimum standards for portfolio companies. Investments have nine sustainable themes split equally among three categories: resources and environment; human rights and social inclusion; and economic development, and fund managers' core strategies are expected to advance at least one of the nine themes.

When Andrew C. Palmer joined the $54.8 billion Maryland State Retirement & Pension System, Baltimore, as chief investment officer in 2015, he started looking at all the asset classes through an ESG lens. "We found we didn't tell anybody what was going on (and) every group did something different," he said. Today, all investment team members meet every Friday to consider ESG decisions through a risk/return lens.

Maryland is also working with its investment consultant during asset allocation practices to analyze how various stress tests impact expected returns and portfolio behavior.

The state of ESG investing today reminds Mr. Palmer of how bond investors in the 1980s learned how to model risk of call options on mortgage-backed securities. "Initially there was a lot of difference of opinion, but eventually it became standardized. This is way more complicated, but eventually we are going to get there," he said.

ESG considerations have led to many changes in how Illinois investment officials analyze investments, said Treasurer Michael W. Frerichs. He was a key force behind the first state law this year requiring state government entities — including the Illinois State Board of Investment, Chicago, overseeing $19 billion in defined benefit plan assets — to integrate sustainability factors into their investment decision-making. "Our hope is that we provide an example. We need to manage risk differently," Mr. Frerichs said.

For the OPTrust managing the assets of the C$22 billion ($16.4 billion) Ontario Public Service Employees Union Pension Plan, Toronto, the growing role of ESG led to a reorganization of the investment office to make sure it is integrated into all investment decisions, said Alison Loat, managing director for sustainable investing and innovation. In addition to assessing the entire portfolio for climate change risk, OPTrust in 2019 engaged hundreds of companies on key ESG issues including gender diversity and board effectiveness and added to its green bond holdings with a $100 million investment in Ontario government green bonds.

ESG "is very much a philosophical underpinning of how we approach our investments," with an eye not just on the sustainability of the fund, "but also the world our beneficiaries retire in," she said.

It is a similar story for Wespath Benefits and Investments, the investments division of the Glenview, Ill.-based $24 billion General Board of Pension and Health Benefits of the United Methodist Church. Wespath built its sustainable economy framework several years ago because "it's embedded in our DNA," said CIO David Zellner. Focused on performance with the benefit of impact, its three components are invest, engage and avoid.

Jonathan Bailey, managing director and head of ESG investing at Neuberger Berman Group LLC, a New York-based global manager with $330 billion under management for institutional investors, 60% of which is ESG-integrated, said that ESG topics "are resonating with clients because they can see it will help their performance. They are also trying to make they sure they understand what it means to their beneficiaries," Mr. Bailey said.

Standards that connect ESG measures to performance and are industry-specific are also driving ESG integration, said Eivind Lorgen, New York-based CEO and president of Nordea Asset Management in North America, a founding member and chairman of the Sustainability Accounting Standards Board's investor advisory group. "Investors are increasingly integrating ESG into their portfolio management, and SASB is emerging as the leading standard now," he said.

SASB's 77 industry standards will continue to evolve to meet investor needs and respond to investor feedback, which, for example, prompted a "huge project" on human capital management, Mr. Lorgen said.

Checking credentials

Institutional investors are increasingly checking their asset manager's sustainability credentials. The CoreData survey found that 49% of global investors now take it into account — up from 39% just two quarters before.

Asset owners have a responsibility to look beyond short-term results while making sure their asset managers also get with the ESG program, said Mr. Zellner of Wespath. "Until asset owners take a longer-term view, our investment managers won't be pressured to take a longer-term view," he said.

That will happen, said Andrew Siwo, director of sustainable investments and climate solutions at the New York State Common Retirement Fund. "When you are writing very sizable checks, I do think you have an opportunity to ensure that the investment managers are aligned with your thinking," he said.

Mr. Siwo and others expect that the next phase of ESG investing will bring a heightened focus on materiality, and what is really driving performance.

Adam Blumenthal, founder and managing partner of private equity firm Blue Wolf Capital Partners LLC in New York, said that limited partners are "increasingly asking private equity managers to identify the link between ESG and value creation," particularly given the massive social impacts of the pandemic and related recession. "Investors should demand that GPs find and execute on those opportunities," Mr. Blumenthal said.