

> **HOLDING INVESTMENT CONSULTANTS TO ACCOUNT:**

A guide for Trustees



Association of Member
Nominated Trustees

UKSIF
UK Sustainable Investment
and Finance Association

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> Forewords



Association of Member
Nominated Trustees

JANICE TURNER, FOUNDING CO-CHAIR, AMNT

New regulations and guidance require pension trustees to ascertain whether environmental, social and governance (ESG) issues are relevant to their investments and if so to take account of them. At the same time, pension scheme members are increasingly scrutinising the activity of their pension funds. Our members tell us they are keen to assume these increased responsibilities and in particular, to abide by the spirit as well as the letter of the new regulations.

The investment consultants are key to enabling trustees to achieve this: in our view, the new regulations, in effect, oblige any consultant of integrity to ensure their clients have the information and guidance in this regard that they should be entitled to expect from their professional advisor. By working with UKSIF to create a coalition of consultants that will recognise this, our intention is ensure that our members are given the professional support that they need. I wish to take the opportunity to thank the consultants for their public commitment on this important issue and look forward to their support in ensuring that fund managers support asset owners' ability to develop their own ESG policies, in line with TPR and DWP requirements. Whilst we have worked with many of the more advanced firms, we are open to linking with other firms of all sizes, business models, who are at different stages of their journey to provide quality ESG advice. The more support that trustees get, the better pensions will be.



SIMON HOWARD, CHIEF EXECUTIVE, UKSIF

As Janice says above, new regulations and growing member interest are increasing the demands on trustees. It is essential that everyone in the pensions value chain reacts to support the thousands of trustees who must deal with these changes. UKSIF is delighted to have been able to help the AMNT convene investment consultants in order to consider how that profession can play a leading role in offering support. We look forward to working closely with the firms named here and to welcoming others. As was the case last year, helping pension schemes protect the assets of their beneficiaries from clearly recognisable threats such as climate change remains core to the work of UKSIF members.

UKSIF
UK Sustainable Investment
and Finance Association

Executive Summary

The provision of quality advice on environmental, social, and governance (ESG) issues by the UK investment consultant industry to its pension fund clients has become paramount in the light of recent regulatory developments, most notably the recent revision to the pension scheme investment regulations. These changes were preceded by the Pensions Regulator's (TPR) guidance which required trustees to take into account financially material ESG issues in its investment strategy. As the various changes played out, the Association of Member Nomination Trustees (AMNT) and the UK Sustainable Investment and Finance Association (UKSIF) secured the public commitment of 16 UK investment consultants to ensure that the TPR's ESG guidance would be brought to the attention of their client bases.

In July 2018, AMNT and UKSIF requested that the 16 firms indicate how they have adhered to their public commitment by outlining how they have reached out to their client base on ESG issues (hereafter referred to as "client outreach"), as well as how their internal governance mechanisms are supporting the provision of ESG advice (hereafter referred to as "internal governance").

The consultant responses were used to inform the development of recommended minimum services and best practice criteria with regards to the procurement and delivery of ESG advice. The findings are summarised below.

KEY FINDINGS

Client Outreach

Trustees require the support of their advisors in respect of ESG considerations in order to meet regulatory requirements. AMNT and UKSIF believe that trustees should be able to expect every investment consultant (with the exception of specialists who have a narrower offering) to offer the following minimum service:

- > Development of trustee beliefs on ESG, including stewardship
- > Development of ESG policies or the integration of ESG considerations into existing policies. This offer to include Statement of Investment Principles revision/preparation
- > Regular training programmes at trustee level on ESG issues
- > Integration of ESG considerations across asset classes
- > Helping trustees to embed ESG considerations into internal governance mechanisms, including non-investment areas (e.g. Risk Register)
- > Manager selection, appointment and monitoring processes on ESG issues
- > Support in internal or external reporting requirements on ESG issues
- > Inclusion of ESG into regular trustee board communications

Best practice elements include:

- > Inclusion of ESG into regular external publications for clients on investment matters
- > The provision of more advanced ESG advice such as climate scenario analysis and stress testing, where applicable to the consultants' business model
- > Inclusion of ESG advice in other service areas within the business (e.g. fiduciary management, actuaries), where applicable to the consultants' business model

Internal Governance

AMNT and UKSIF believe that in order to strengthen the quality of ESG advice, minimum requirements must also extend to the consultants' internal governance arrangements, such as:

- > Evidence of demonstrable leadership from the top of the organisation which shows notable outputs at the field consultant level. This includes public transparency and accountability for the firm's ESG approach.
- > Compulsory regular training (for both new and existing personnel) in formats that demand feedback and engagement, as opposed to one-way communication channels
- > Regular evaluation of training effectiveness and senior management leadership on ESG

Best practice elements include:

- > Integration of ESG objectives into staff performance evaluation
- > Mechanisms for assessing the effectiveness of their ESG activities, and transparency about that effectiveness to key stakeholders

Recommendations for trustees and consultants based on these findings are provided below.

RECOMMENDATIONS

Trustees

Trustees should conduct a skills analysis of their investment consultant to determine whether their consultants provide advice that falls below minimum services. To support them in this determination, trustees can use independent advisors, or seek feedback from the fund management community. If the consultant is a Principles for Responsible Investment (PRI) signatory, the trustee can also ask for their transparency report. It is our view that understanding consultants' processes for including ESG in manager selection, appointment and monitoring is of particular importance given the recent DWP regulatory changes.

If any material gaps are identified in the consultants' skill set, trustees can seek a commitment from the consultant to fill them within a reasonable timeframe. If the consultant does not agree to this commitment or is unable to meet the agreed timeframe, the trustees can either procure that advice from another consultant or consider this development in the round when the contract is up for renewal.

For some consultants, the provision of more advanced ESG advice such as climate scenario analysis and stress testing may not be relevant to their business model. While we would not say that the provision of this type of advice is currently a minimum requirement across the industry, we would still recommend that trustees ask their consultant (especially if it offers a wide range of client services) whether it offers this type of service and if not, why. At this time of change, a risk to trustees is that ESG is rapidly recognised as essential in more and more areas of work. With consultants whose business models allow for this type of advice, trustees should monitor the consultant's development in these areas and obtain a commitment from them as to how they will evolve their client offering over time.

Consultants

Driven by the regulatory changes mentioned above, consultants should plan to meet minimum services as soon as possible or risk losing clients that respond to the increasing demands laid upon them. In particular, they should focus on fund manager selection, appointment and monitoring processes as highlighted. To protect their position, they should communicate their plans or current capacities to client bases.

Given the growing scrutiny on investment consultants regarding the provision of ESG advice, consultants should publicly state their approach to ESG, including their ESG beliefs, and they should demonstrate senior management accountability for ESG issues.

Those not yet providing or developing more advanced advice, should consider doing so by investing in staff, products and tools to better assess ESG issues at more levels and across more business streams. We think this will be crucial for pension fund clients as the regulatory changes and TPR advice "bed down" in future years.

Introduction

BACKGROUND AND CONTEXT

The integration of environmental, social and governance (ESG) issues into investment processes has been rapidly rising up the pension agenda over the past few years, especially at a regulatory level. In March 2017, the Pensions Regulator (TPR) issued investment guidance which included new requirements on environmental, social, and governance issues. It required Defined Benefit trustees to “take environmental, social, and governance (ESG) factors into account if you believe they are financially significant”. The Department of Work and Pensions (DWP) has issued new regulations on ESG, including stewardship¹, which require trustees to state their policy in these areas and be publicly accountable for them. Further, the Financial Stability Board’s Taskforce on Climate Related Disclosures (TCRD)² has made recommendations for asset owners on how they should incorporate climate risks into their investment decision making processes.

During this time of regulatory change, the Association of Member Nominated Trustees (AMNT) and the UK Sustainable Investment and Finance Association (UKSIF) both shared the same concern regarding the quality of ESG advice being provided to their pension fund members. Feedback from some AMNT members suggested that consultants were either not interested in providing such advice, or that there was a disconnect between the quality of the advice at head office in the ESG teams (adequate), and that of the field consultants who had the primary relationship with the trustees (poor to non-existent). UKSIF members from several points in the pensions value chain echoed these thoughts. Given the significant influence that investment consultants have with both their pension fund clients and the fund management community, the varying experience of service levels represented a significant barrier to pension funds making the necessary changes in their treatment of ESG issues. This issue is further exacerbated when one considers that:



Trustees are required to have regard to their professional advisors;



The overwhelming majority of UK pension funds consist of small, resource-constrained, externally managed schemes whose trustees find themselves in a vicious circle on ESG matters: the fact that they receive little to no advice on ESG leaves them ill-equipped to challenge their consultants on the matter, who in turn assume that there is no client interest and therefore fail to raise the issue.



Fund managers are often unwilling to adopt the ESG policies of their clients, especially those in pooled fund arrangements

Therefore, trustees were left with rising regulatory requirements on ESG issues as shown by the TPR guidance, but with insufficient support from their advisors on how to adhere to them. It was then that AMNT and UKSIF decided to reach out to the investment consultant community to find a solution to this issue.

¹ <https://www.gov.uk/government/consultations/pension-trustees-clarifying-and-strengthening-investment-duties>. We recognise that the DWP regulations separate the term “ESG” from “stewardship”, but in the interests of simplicity and for the purpose of this report, we will assume ESG includes stewardship considerations

² <https://www.fsb-tcfd.org/>

THE AMNT/UKSIF INVESTMENT CONSULTANT INITIATIVE

AMNT and UKSIF engaged with investment consultants in phases between June 2017 and January 2018 to examine their commitment, to promoting the TPR's ESG guidance. The outcome was that AMNT and UKSIF secured a public commitment from the following 16 investment consultants to bring TPR's ESG guidance to their client base, with the commitment published in September 2017 and January 2018 respectively.



HOLDING SIGNATORIES TO ACCOUNT

In July 2018, AMNT and UKSIF wrote to the 16 investment consultants asking for details on how they had sought to meet their commitment including their future plans with respect to the development of ESG advice. In a subsequent email, we provided suggestions as to the areas their responses might cover. We were keen to allow each consultant to explain their response and we did not want to be too prescriptive; on the other hand, by giving some prompts from the perspective of the client and a sector observer we thought we would enable practical, relevant feedback. We provided suggestions along the following lines:

- > To focus on the scale and impact (or effectiveness) of their client outreach on ESG, rather than more boilerplate statements such as “We have conducted training programmes on ESG to our client base”.
- > Asking about any internal governance changes that have helped to better support adherence to the AMNT-UKSIF statement (such as training requirements for field consultants for example).
- > We asked for explicit reference to field consultants where applicable.

We received responses from 15 consultants between July and November 2018. As of November 2018, Quantum Advisory had not provided a response to our request.

We stress that our focus has been on change after the public commitment made by the consultants. We have not attempted to rank the firms on their overall approach to ESG as we did not ask for this information. They are all trying to respond to these important changes and we are interested in flagging that. The willingness of firms to respond to help trustees is very encouraging.

Discussion of findings

INTRODUCTION

Looking at the responses it became apparent that despite our efforts, comparison could not be done on an “apples to apples” basis, since each consultant is at a different stage in their journey with respect to their ESG advice. Some of the larger consultants have been in ESG for many years and thus have had more time to develop a more sophisticated approach. However, those issues notwithstanding, we noted some recurring themes in the responses and these are discussed below with two aims:

- > To help trustees evaluate consultants and to hold them to account for the service they provide
- > To provide consultants that are still in the early stages of the evolution of their ESG practice with advice as to what constitutes minimum services and evidence of best practice in our view

The responses were divided into the following themes:

- > Client training programmes, ESG information in trustee board communication and external publications on ESG issues - hereafter referred to as client outreach
- > Evidence of leadership on ESG issues, ESG integration into staff performance evaluation processes, training of investment consultants and evaluating effectiveness in their ESG approach - hereafter referred to as internal governance

An overarching summary of each theme is provided in the next section, each containing the following sections:

- > **Key findings**
- > **Discussion of key findings**
- > **Recommendations** – noting whether the theme in question should be considered a best practice element or minimum requirement for the industry.
- > **Select examples** are highlighted to demonstrate how firms have responded to each theme. Please note that this is not meant to be comprehensive. The absence of inclusion of other firms does not necessarily mean that they do not perform this practice as the request was for activities undertaken after signing the statement.
- > **Issues for trustees to raise** with the consultants



CLIENT OUTREACH

Client training programmes



Finding

Over 80% of the consultants indicated that some type of training programme on ESG was provided to their clients. The detail in responses regarding the type of client training programme varied, but examples were cited which ranged from emailing guidance documents and hosting webinars and group training sessions/seminars, to more intensive approaches such as training courses for individual trustee boards. However, overall, there was a general lack of any indication of impact of these client training programmes on subsequent advice provision or indeed the scale of the effort (e.g. % of client base).



Discussion

We feel that those investment consultants who are focusing the majority of their resources on one-way communication approaches such as emailing guidance documents or webinars will not achieve the kind of impact that is needed to satisfy evolving client needs. While group client training sessions for an invited audience have their place in the overall strategy, we consider that for clients to build up their technical capabilities in this area, training should be given to the trustee board as part of their board or investment subcommittee agenda. Trustees may decline invitations to seminars or roundtables, especially given their time constraints and reported difficulties in obtaining time away from work to attend. Proactivity is required on the part of both trustees and consultants to arrange regular training during their trustee meetings.

We believe that training of pension fund trustees is a fundamental part of ensuring that they adhere to recent regulatory developments on ESG. Whilst it is hard to prove a negative, the lack of data on the scale of effective training for clients suggests that the profession might struggle to prove it is putting appropriate effort into the process given the key role of consultants in trustee advice.



Recommendation

We consider the inclusion of regular client training on ESG issues to be a **minimum requirement**, with a preference for training during or alongside trustee meetings (versus one-way communication vehicles such as bulletins, publications, or guidance documents).

Some examples from the responses:

Aon – State that they are on course to have delivered close to 70 client training sessions by the end of 2018.

Barnett Waddingham, Willis Towers Watson³, Aon and Cambridge Associates⁴ (those who specifically reference bringing TPR guidance to client base)

Hymans – Training identified as a key ESG initiative for pension funds

Mercer – Training “intensified during 2017/2018”

Redington – ESG training for trustee boards is part of their standard offering



Issues for trustees to raise with consultants

- > Can you conduct a skills assessment of the trustee board regarding knowledge of ESG issues and create a suitable training programme to address any gaps identified?
- > How many training programmes did you offer your clients over the calendar year? Of the total, which percentage were one-way communication approaches versus more intensive approaches such as trustee board sessions?
- > How do you evaluate the effectiveness or impact of your training sessions?

³ <https://www.willistowerswatson.com/en/insights/2018/06/sustainable-investment-time-for-everyone-to-translate-thinking-into-action>

⁴ <https://www.cambridgeassociates.com/research/newly-issued-guidance-uk-pension-schemes-emphasizes-need-consider-esg-factors/>

CLIENT OUTREACH

ESG information within trustee board communication



Finding

A few investment consultants noted the inclusion of ESG within board meeting packs or as agenda items.



Discussion

We do not wish to be prescriptive at this stage as to how ESG gets communicated at trustee boards. It may be easier for pension fund trustees in the early stage of their responsible investment policy development to include it as a separate item. However, over time they may wish to include it as a discussion point within many elements of the regular agenda items (such as investment beliefs, investment strategy, risk management etc.). Ultimately, it is up to the trustee board to decide the most effective communication mechanism. However, we do believe that it is important that ESG issues are communicated at board level on a regular basis, and that those communications are minuted.



Recommendation

We believe the inclusion of ESG as part of regular trustee board communication should be a **minimum requirement, recognizing the form may vary**.

Some examples from the responses:

Cardano, JLT, LCP, Willis Towers, and Watson, all have noted current or future inclusion of ESG information within trustee board communication.



Issues for trustees to raise with consultants

- > Please include ESG as a regular item on our board agenda and please discuss how to manifest that given our governance structure (e.g. separate item, versus integrated in numerous sections).
- > How proactive are you at ensuring it is included as a regular board item, or do you leave it for the client to ask?

CLIENT OUTREACH

ESG advice outside investment services



Finding

A few consultancies noted the expansion of their ESG advice across other service lines, most notably into fiduciary management and actuarial services.



Discussion

While the remit of this project is focused on investment consultants, the corporate centre should focus on how ESG can add value to their client base across other service areas. In determining how embedded ESG is in the organisation at group level as part of service evaluation, the degree to which ESG advice has crossed over to other services is crucial.



Recommendation

We would consider the expansion of ESG advice to other service lines within the organisation to be **best practice**.

Some examples from the responses:

Aon and LCP have conducted some work in the actuarial space, while Willis Towers Watson noted work in the fiduciary management space.



Issues for trustees to raise with consultants

- > Have you incorporated ESG advice into your other service offerings, most notably fiduciary management and actuarial services? If not, what are your plans to do so in the future?

CLIENT OUTREACH

External publications on ESG issues



Finding

Many responses focused on external publications dedicated to ESG issues in a rather one-off, seemingly ad-hoc fashion (e.g. feature publications). However, a few consultants noted that ESG issues were more formally embedded as a regular theme for discussion (e.g. as part of a quarterly investment review or market outlook for example).



Discussion

We do not wish to discount the value of ad-hoc publications dedicated to ESG issues in absolute terms. However, if that is the only type of publication that is offered by the consultancy, and thus ESG issues are not integrated into regular publications and presented as “mainstream”, it could signal that ESG is not truly integrated into the consultant’s business model. Certainly, the presence of ESG issues within regular investment reviews sends a positive message to clients who receive these publications that these risks are considered to be financially material to clients’ assets by the investment consultant.



Recommendation

The inclusion of ESG issues within regular investment publications would be considered **best practice**.

Some examples from the responses:

JLT, LCP, Mercer, and Willis Towers Watson, noted inclusion of ESG issues within their regular investment publications.



Issues for trustees to raise with consultants

- > Please include ESG as a regular item on our board agenda and please discuss how to manifest that given our governance structure (e.g. separate item, versus integrated in numerous sections).
- > What percentage of your external publications for clients cover ESG issues and are they one-off ad-hoc reports or, for example, integrated with your quarterly review/market outlook?

INTERNAL GOVERNANCE

Leadership



Finding

Some investment consultants noted the creation (or pre-existence) of some type of internal governance committee on ESG issues. A few noted that their CIO had ultimate accountability for ESG issues. Several others highlighted their own responsible investment beliefs.



Discussion

Given the differing business models and sizes of the signatories, each consultant should decide what particular governance mechanism works best for them. Done effectively, this leadership signal will travel all the way to the field consultant showing that ESG advice is a core part of the business and not simply a marketing exercise reflecting fashion. Regular evaluation of senior management leadership on ESG should be undertaken, to ensure that the leadership signal does not waver.

The organisation should also be publicly transparent and accountable for their ESG approach⁵. One such example of demonstrable leadership would be a public statement on their responsible investment approach, including their responsible investment beliefs, and the mechanism for oversight on ESG issues with evidence of top management accountability.



Recommendation

We consider it to be a **minimum requirement** that there is evidence of demonstrable leadership from the top of the organisation which shows notable outputs at the field consultant level.

Some examples from the responses:

Responsible investment beliefs – Hymans, JLT, Mercer⁶, (to be published in near future).

Internal governance committee on ESG issues (or similar) – several, including Allenbridge, Cardano, JLT, **LCP, Redington, Willis Towers Watson**, XPS Pensions Group, (in bold are those who highlighted top management accountability for ESG issues).



Issues for trustees to raise with consultants

- > Can you provide us with evidence that the senior management formally supports ESG being considered as core advice? How do you ensure that this is sustained?
- > How does the named senior manager ensure that message is implemented by the field consultant?

⁵ If the organisation is a PRI signatory, publication of their yearly PRI report would help to serve this purpose

⁶ <https://www.mercer.com/our-thinking/wealth/mercer-investments-beliefs.html>

INTERNAL GOVERNANCE

ESG Integration into Staff Performance Evaluation Processes



Finding

A few investment consultants noted the recent integration of ESG issues into their strategic planning and their staff performance evaluation processes.



Discussion

As noted above, AMNT/UKSIF members had identified a disconnect in some consultancies between the head office position on ESG issues and the position of their field consultants who have the primary relationship with the trustees. Subsequently the EU High-Level Group on Sustainable Finance made a similar observation. Integrating an ESG element into staff performance evaluation might serve to close this gap. Given that this inclusion appears to be at a relatively early stage of implementation, we will continue to monitor its progress with interest, as we believe it to be key to promoting the message in consultant firms. This may be especially true for those more experienced field consultants who have been providing advice for a long time without focusing on ESG. In order to help change that pattern, a formalised requirement to raise ESG with clients clearly endorsed by senior management through HR processes may be necessary.



Recommendation

We consider the integration of ESG into staff performance evaluation to be **best practice**.

Some examples from the responses:

Redington – ESG integration is an explicit performance objective for several senior team leaders including top management responsible for clients.

Willis Towers Watson – They state that they “held their annual sustainable investment summit, gathering the most senior leaders from various parts of their global business to discuss and agree priorities, objectives and commitments for the year ahead. This was widely socialised, embedded within individual performance objectives (therefore aligning with annual reviews and assessments), and formalised within a detailed project management framework overseen by their project management office”.



Issues for trustees to raise with consultants

- > Have you set ESG strategic objectives for your organisation? If not, why?
- > If not embedded into a human resource framework/performance evaluation, how have you ensured that ESG is being integrated into your core offering, from senior management to the field consultant?

INTERNAL GOVERNANCE

Training of investment consultants



Finding

Approximately 75% of the investment consultants had either created new ESG training programmes for their employees or were updating their existing training programmes on ESG issues. The detail in responses regarding internal training programmes varied, but certain trends emerged from our analysis.

- > Voluntary versus compulsory training – there was a large number of responses which did not specify whether the internal training was compulsory or voluntary, whilst a few mentioned it as being either one, the other or both depending on the employee type (new/pre-existing).
- > Type of internal training programmes – there was a wide range of responses regarding the type of training programmes provided to their consultants, from emailing guidance documents to webinars to in-person group training sessions.



Discussion

An effective internal training programme should ensure that all consultants, most notably field consultants who have the primary relationship with trustees, are well versed in ESG matters. It is therefore highly recommended that the internal training is conducted on a regular basis and is made compulsory for field consultants. In our view, this is crucial to addressing one of the previously referenced concerns highlighted by the High-Level Expert Group on Sustainable Finance⁷. If the training is voluntary, this sends a signal within the organisation that ESG is not part of the core advice offering and will also result in inconsistent ESG advice being provided to clients (as some will have attended the training, and some not).

Consultant firms should perhaps also be held to account for the styles of their internal training programmes. We do not wish to be overly prescriptive in this area. However, in our view, a training programme will be more effective if it promotes feedback and engagement (e.g. in-person sessions) versus one-way communication tools. This is especially key given that the content may be markedly new to some trainees. Whatever the type of internal training programme selected, its effectiveness should be evaluated on a regular basis and revised if necessary.



Recommendation

We believe compulsory regular training (both for new and existing personnel) which supports feedback and engagement, as well as a regular evaluation of its effectiveness to be a **minimum requirement**.

Some examples from the responses:

Aon – Developed a framework designed to help consultants engage with trustees around ESG, and have run numerous ESG Roadshows across the UK for all colleagues in both investment and retirement.

Hymans – Instigated quarterly ESG training sessions for all investment staff this year, mandatory ESG training for new staff.

LCP – training compulsory for investment staff, numerous training programs cited.

Mercer – Ongoing intensification of training to consultants on ESG issues. ESG also embedded into their HR competency framework.

Redington – Numerous training programmes cited, endorsed by the Head of Investment Consulting.

Willis Towers Watson – Training programme on ESG issues continues to be integrated throughout the organisation from interns to technical personnel, as well as a series of refresher training courses for field consultants.

XPS Pensions Group – Training materials being developed for internal training, initially i.e. to all consulting teams, which will then evolve into external, client-focused training material.



Issues for trustees to raise with consultants

- > Is ESG training of investment consultants and staff compulsory and how is it embedded into performance evaluation? How many hours are staff required to complete within a calendar year?
- > Is ESG training conducted in an ad-hoc fashion or is it more formalised?
- > What type of training do you provide? Does it encourage feedback and engagement?

⁷ https://ec.europa.eu/info/sites/info/files/170713-sustainable-finance-report_en.pdf. “There is a question over the relevant competencies of investment consultants’ field staff, which may be very separate and disconnected from ‘responsible investment’ specialists at the consultant. These governance arrangements often limit the ability of pension funds to deal with emerging risks, and especially long-term sustainability risks”.

INTERNAL GOVERNANCE

Assessing the effectiveness of their responsible investment activities



Finding

In terms of client outreach, very few consultants provided numbers to substantiate the scale and impact of their responsible investment efforts as was recommended in our initial feedback to them (cf. Introduction – Holding signatories to account). However, one investment consultant said that they evaluate the impact of their ESG offering on clients, on an annual basis, and develop any action plans if targets have not been met.



Discussion

As highlighted in the Background section above, AMINT and UKSIF are just two of many organisations that have highlighted difficulties in the provision of ESG advice to trustees. The EU High-Level Expert Group on Sustainable Finance identified in their July 2017 interim report the disconnect issue regarding field consultants was a systemic barrier to sustainable investment that needed to be addressed. Other stakeholders such as the PRI and Client Earth have also prioritised investment consultants as part of their campaigning efforts. This pressure to provide quality ESG advice will increase in light of growing regulatory requirements. As a result, there will be a growing need for consultants to demonstrate the effectiveness (including impact and scale) of their responsible investment activities in part through tangible data.



Recommendation

We think evaluating the impact and effectiveness of their work is a best practice element that all investment consultants should at least consider. As an illustration, consideration could be given to examining the following in order to be able to demonstrate the impact of their ESG offering:

- > Develop customer relationship management systems to support the tracking of their progress with clients on ESG advice.
- > Use this system to generate public reports on their yearly progress in the interest of stakeholder accountability. We recognise that any PRI signatories will be producing reports to this effect somewhat, however the data provided to the PRI will only continue to be as good (or as bad) as the data management systems possessed by the consultant.

Some examples from the responses:

bfinance, Hymans, and Redington, (provided tangible data to demonstrate scale of impact).

Willis Towers Watson (evaluation of effectiveness on a client by client basis).



Issues for trustees to raise with consultants

- > How do you demonstrate the value or impact of your responsible investment proposition internally and how is that embedded into performance evaluation?
- > If the consultant has dedicated RI teams – how do you evaluate the effectiveness of their roles, both internally and externally, and how is that embedded into their performance evaluation?
- > Can you demonstrate how your strategy regarding industry engagement creates value for your clients, and for our fund specifically? How do you demonstrate that internally?

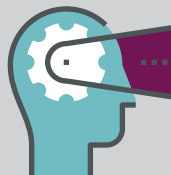
> Holding consultants to account for the provision of ESG advice

INTRODUCTION

Given the regulatory requirements placed upon them, it is imperative that trustees hold consultants to account for the quality of the ESG advice being provided to them. Trustees will require support from other investment actors in order to accomplish this; for example, feedback from other advisors, fund managers and, if the consultant is a PRI signatory, their annual transparency report⁸. We recognise the diversity of both the business models of investment consultants and the particular needs of pension funds. However, we believe it is appropriate and helpful to trustees to divide ESG advice into two categories as follows:



minimum requirements for the industry in order for clients to meet regulatory demand; and,



more advanced advice, for example climate change modelling, stress testing, assessing the impact of macro ESG trends (other than climate change) on the portfolio.

Whilst not intended to be a hard and fast rule, the advice has been categorised in this way solely for the purpose of this report in order to help trustees understand better how to hold consultants to account for their service. The following sections discuss this further.

⁸ <https://www.unpri.org/signatories/reporting-for-signatories>

MINIMUM REQUIREMENTS

Client Outreach

AMNT and UKSIF believe that trustees should be able to expect every investment consultant (with the exception of specialists who have a narrower offering) to offer the following minimum service:

- > Development of trustee ESG beliefs
- > Development of ESG policies, including stewardship (or integration of ESG considerations into existing policies), including Statement of Investment Principles revision/preparation
- > Regular training programmes at board level on ESG issues
- > Integration of ESG considerations across asset classes
- > Helping trustees to embed ESG considerations into its internal governance mechanism, including non-investment areas (e.g. Risk Register)
- > Manager selection, appointment and monitoring processes on ESG issues
- > Support in internal or external reporting requirements on ESG issues
- > Inclusion of ESG into regular trustee board communications

As some notable examples, Hymans stated that they “have focused on both training and the development of investment beliefs as key responsible investment initiatives for pension funds, recognising that these are areas which have widespread application across <their> client base, regardless of their attitude to responsible investment”. Mercer stated that they have updated their template SIP to include ESG, climate change and stewardship as per DWP regulations (Cardano also indicated plans to update their template SIP).

One of the most critical offerings for minimum services is manager selection, appointment and monitoring processes on ESG issues, which should include the setting of trustee expectations of fund managers on ESG issues and requesting improvement of their ESG approach over time. If the consultant does not have or plan to have these processes in place within a reasonable timeframe, trustees may need to consider their options. In this new regulatory environment, it is important that trustees take a more proactive stance in formulating their own ESG policies, working to have their fund managers respond to these policies, as well as holding their managers to account for their own ESG approach. In particular, trustees need to consider their position in this area since the conventional boilerplate SIP statement “we delegate stewardship responsibilities to our managers” may not meet the requirements of the DWP regulations. Therefore, your adviser needs to engage with fund managers on your behalf to improve their approach to ESG should areas for improvement be identified. As notable examples, LCP and bfinance offer this type of fund manager engagement and request for improvement.

There are also other best practice elements in this area which are also worthy of consideration by the trustee including:

- > Inclusion of ESG into regular external publications for clients on investment matters
- > The provision of more advanced ESG advice such as climate scenario analysis and stress testing, where applicable to the consultants' business model (cf. below section on advanced advice)
- > Inclusion of ESG advice in other service areas within the business (e.g. fiduciary management, actuaries), where applicable to the consultants' business model

MINIMUM REQUIREMENTS

Internal Governance

We also believe that in order to strengthen the quality of ESG advice, minimum requirements must also extend to the consultants' internal governance arrangements, such as:

- > Evidence of demonstrable leadership from the top of the organisation which shows notable outputs at the field consultant level. This includes public transparency and accountability for the firm's ESG approach.
- > Compulsory regular training (for both new and existing personnel) in formats that demand feedback and engagement, as opposed to one-way communication channels.
- > Regular evaluation of training effectiveness and senior management leadership on ESG.

There are also other best practice elements in this area which are also worthy of consideration by the trustee including:

- > Integration of ESG objectives into consultants' business models including staff performance evaluation; and,
- > Development of mechanisms for assessing the effectiveness of their ESG activities.

With support from other investment actors as previously identified, trustees should conduct a skills analysis of their investment consultant to determine whether their consultants provide advice which falls below minimum requirements. It is our view that advice pertaining to the development of manager selection, appointment and monitoring processes on ESG issues is of particular importance, given the recent DWP regulatory changes.

If any material gaps are identified (i.e. advice that the trustee is and will be seeking), trustees can seek a commitment from the consultant to fill this gap within a reasonable timeframe. If the consultant does not agree to this commitment or is unable to meet the agreed timeframe, the trustees can either procure that advice from another consultant or consider this development in the round when the contract is up for renewal.

ADVANCED ADVICE

For the purposes of this report, Advanced Advice can be defined as that which would fit within the definition of thought leadership or the conversion of thought leadership into relatively new or "first-mover" products and services. This would include services such as climate risk modelling and stress testing. A few consultants have made impressive strides in this area over the past few years. One can see the trend from the development of thought leadership reports on these topics a few years ago to the current development of innovative tools to help clients address these risks. This is a positive sign and this momentum needs to continue.

While we would not expect the provision of this type of advice to be a minimum requirement across the industry, we would still recommend that trustees ask their consultant (especially if it offers a wide range of client services) as to whether it offers this type of service and if not, why. If the trustee has an investment consultant who already offered this type of advice as highlighted in this report, they should monitor the consultant's development in this area and obtain a commitment from them as to how they will evolve their client offering over time. Demonstrating innovation from those offering this type of advice is crucial to ensuring that the advice remains robust and in keeping with market developments.

Examples of advanced advice

Aon

- > Development of climate change deterministic scenarios to aid clients with understanding its impact on assets and liabilities⁹.

Mercer Investments

- > Refinement of manager monitoring tool to enable better utilisation for portfolio monitoring and selection decisions
- > 2018 ESG/sustainability allocations into Mercer Reference Portfolios
- > Climate services to clients are being expanded – including an integrated approach to all stress/strategy testing processes and a comprehensive Task Force on Climate Change Related Disclosures service.

Redington

- > Researching the best way to integrate ESG information into their model portfolios (ongoing project).

Willis Towers Watson

- > Development of climate change scenarios that can be applied to asset class returns to assess portfolio positioning relative to a series of climate change pathways
- > Development of a tool to map physical risk exposures of certain investments to a series of climate change risks (including client engagement)
- > Development of a framework to assess portfolio resilience against a series of sustainability issues and long-term trends. This can be applied across a multi-asset portfolio harnessing unstructured big data techniques as well as building on the megatrends research referenced above.



Issues for trustees to raise with consultants

Below are suggested questions pertaining to the provision of ESG advice that trustees can ask consultants. Note that these questions may not be suited to those specialist consultants who have a narrower offering.

- > Can you provide me with a list of the types of ESG advice that you currently provide and those which you plan to provide over the course of the next year?
- > Do you provide all the advice that falls under minimum services as defined in this report? If not, do you have a plan to incorporate this in your future offerings? (for those trustees who are interested in advanced advice but at a preliminary stage)
- > What type of advanced advice do you provide? If you do not provide this type of advice, why?
- > What is your approach and thought process behind the provision of this advice at this stage?
- > Can you tell me how you are innovating in these areas over the next few years? (For those trustees who identify climate change as a systemic risk to their fund asking consultants who can provide advanced advice)
- > Can you demonstrate the robustness of your climate scenario analysis and stress
- > Can you support our pension scheme in its efforts to adhere to Taskforce for Climate Related Disclosure requirements?

⁹ <http://www.aon.com/getmedia/8ddb2a56-c1a9-4689-81e6-f3b7c178e57c/Climate-Change-Challenges.aspx>
<http://www.aon.com/getmedia/e8648ded-3146-4a81-9887-65a02d8f49fe/Climate-Change-Challenges-Case-Studies.aspx>

> Concluding remarks

The purpose of this initiative is to ensure the provision of good quality advice to trustees. A very pleasant part of that work is that we can flag the excellent work underway among the investment consultant industry with regards to the offering of ESG advice.

But before anyone relaxes, we repeat that we think that the needs of trustees and thus minimum requirements of service provision will evolve rapidly. We want our work to help raise the bar such that trustees can meet growing regulatory requirements in this area.

We hope that this report is helpful in identifying what we deem to be a **minimum ESG services** which consultants developing ESG expertise should focus on if they are not already in place. We also suggest some best practice elements that consultants may wish to strive for. From an internal governance perspective, it is crucial that the appropriate mechanisms are in place to support signaling from top management, right down to the client-facing field consultant, on the importance of providing high quality ESG advice. Consultants need to evaluate the impact of their ESG offering, so as to better tailor it to client needs and to be publicly accountable. No matter what stage the consultant is at in their ESG journey, innovation needs to be at the cultural heart of the organisation, with top-down and bottom-up communication flows, to ensure it is continuously progressing and keeping up with market developments.

We hope that trustees find the information contained within this report useful in holding their consultants to account for their ESG approach as part of their service evaluation. We recognise this is a two-way street of communication and the trustees need to play their part in raising the bar. We want to help them in this endeavour.



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> Appendix

ISSUES TO RAISE WITH CONSULTANTS

Client Outreach

Client training programmes

- > Can you conduct a skills assessment of the trustee board regarding knowledge of ESG issues and create a suitable training programme to address any gaps identified?
- > How many training programmes did you offer your clients over the calendar year? Of the total, which percentage were one-way communication approaches versus more intensive approaches such as trustee board sessions?
- > How do you evaluate the effectiveness or impact of your training sessions?

ESG information within trustee board communication

- > Please include ESG as a regular item on our board agenda and please discuss how to manifest that given our governance structure (e.g. separate item, versus integrated in numerous sections).
- > How proactive are you at ensuring it is included as a regular board item, or do you leave it for the client to ask?

ESG advice outside investment services

- > Have you incorporated ESG advice into your other service offerings, most notably fiduciary management and actuarial services? If not, what are your plans to do so in the future?

External publications on ESG issues

- > What percentage of your external publications for clients cover ESG issues and are they one-off ad-hoc reports or, for example, integrated with your quarterly review/market outlook?

Internal Governance

Leadership

- > Can you provide us with evidence that the senior management formally supports ESG being considered as core advice? How do you ensure that this is sustained?
- > How does the named senior manager ensure that message is implemented by the field consultant?

ESG Integration into Staff Performance Evaluation Processes

- > Have you set ESG strategic objectives for your organisation? If not, why?
- > If not embedded into a human resource framework/performance evaluation, how have you ensured that ESG is being integrated into your core offering, from senior management to the field consultant?

Training of investment consultants

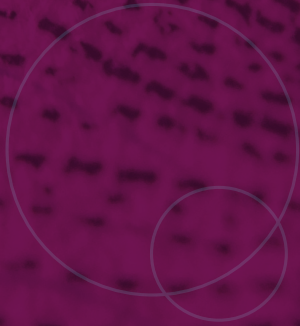
- > Is ESG training of investment consultants and staff compulsory and how is it embedded into performance evaluation? How many hours are staff required to complete within a calendar year?
- > Is ESG training conducted in an ad-hoc fashion or is it more formalised?
- > What type of training do you provide? Does it encourage feedback and engagement?

Assessing the effectiveness of their responsible activities

- > How do you demonstrate the value or impact of your responsible investment proposition internally and how is that embedded into performance evaluation?
- > If the consultant has dedicated RI teams - how do you evaluate the effectiveness of their roles, both internally and externally, and how is that embedded into their performance evaluation?
- > Can you demonstrate how your strategy regarding industry engagement creates value for your clients, and for our fund specifically? How do you demonstrate that internally?

Provision of ESG advice

- > Can you provide me with a list of the types of ESG advice that you currently provide and those which you plan to provide over the course of the next year?
- > Do you provide all the advice that falls under minimum services as defined in this report? If not, do you have a plan to incorporate this in your future offerings/ (for those trustees who are interested in advanced advice but at a preliminary stage)?
- > What type of advanced advice do you provide? If you do not provide this type of advice, why?
- > What is your approach and thought process behind the provision of this advice at this stage?
- > Can you tell me how you are innovating in these areas over the next few years? (For those trustees who identify climate change as a systemic risk to their fund asking consultants who can provide advanced advice)
- > Can you demonstrate the robustness of your climate scenario analysis and stress?
- > Can you support our pension scheme in its efforts to adhere to Taskforce for Climate Related Disclosure requirements?



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