Spotlight on Pensions
PRESENTS
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Impact investing – time to get serious

Trustees have a duty to look after the interests of their members under the scheme. But to what extent could or should they also be good neighbours? When it comes to investing scheme monies, should they take a broad approach, specifically incorporating social issues?

Trustees must consider and record in their Statement of Investment Principles (SIP) the extent to which they take account of environmental, social and governance (ESG) issues. In the past many SIPs contained bland wording to the effect that the trustees took ESG issues into account to an appropriate extent, balanced with investment return. At best ESG fell well behind more obvious and expected short-term financial returns, and often was not considered at all. The judgment in the case of *Cowan.v.Scargill* was often misinterpreted as requiring trustees to invest solely to obtain the best short-term financial returns. This was bolstered by prevailing opinion that the best returns could not be obtained where the focus on achieving profit for investors was diluted by the need to consider "doing good".

Even where companies in which schemes invested purported to be embracing ESG issues, this was frequently a sideline to the short-term profit goal. There was little consistency around approaches to these issues, meaning that measurement of the impact and benefits was difficult to assess. Consequently, investors including pension scheme trustees felt more comfortable investing on what seemed the safer ground of clearly-identifiable financial performance.

In the UK, pension scheme trustees have also been encouraged to take a broader view of investing by Law Commission reports in 2014 and 2017, rather than investing exclusively on the basis of expected short-term profit.

However, the world has moved on. Concerns have grown about the impact on economies and societies of unabated private sector globalisation and the single-minded pursuit of short-term profits for shareholders. The UN developed a set of Sustainable Development Goals which is beginning to improve investor understanding and boost confidence in the strategic relevance of non-financial measures. Studies also began to demonstrate that profits and the adoption of ESG principles, far from being incompatible, could be mutually beneficial.

UK pension scheme trustees

In the UK, pension scheme trustees have also been encouraged to take a broader view of investing by Law Commission reports in 2014 and 2017, rather than investing exclusively on the basis of expected short-term profit. In the first, they softened the widespread interpretation of the *Scargill* decision by saying that broader issues could be taken into account where to do so would not involve a risk of significant financial detriment to the fund and the trustees have good reason to believe the members would embrace those non-financial issues.

In the second, they went further, to consider positive social investing – i.e. using scheme monies to invest in socially responsible organisations and infrastructure projects for greater social good. They found no legal barriers to pension schemes incorporating such principles in their investing where for example a majority of members were likely to support particular investments, or reject others.

Moving on – social impact investing

The report "Growing a culture of social impact investing in the UK" by an independent group set up in 2016 to advise the Government, takes the issue further. Social impact investing is defined in the report as "Investment in the shares or loan capital of companies and enterprises that not only measure and report their wider impact on society – but also hold themselves accountable for delivering and increasing positive impact". The report contains a comprehensive range of recommendations for the short, medium and longer-term addressed to businesses and those that invest in them. The expectation is that investment professionals will continue to develop their ability to measure non-financial outcomes, creating investment opportunities across the full spectrum of social impact enterprises.

Pension schemes at the forefront?

Pension schemes are amongst those investors expected to take advantage of the growing opportunities that will emerge. A recent survey of 1,800 individual investors in the UK, quoted in the report, showed that 56% had at least a moderate interest in impact investing. The report recommends that trustees should, as part of their general efforts to improve member engagement, improve members' understanding of the potential benefits of social impact investing.

Due to automatic enrolment and continued low levels of other savings, a growing proportion of the population's wealth will be held in pension schemes. Trustees and managers will feel increasing pressure to incorporate social impact considerations into investment strategies.

DC schemes will be expected to offer compliant funds to members, and to incorporate them into default funds that will continue to hold the lion's share of assets. DB scheme members will also begin to take a greater interest in where the funds underpinning their pensions are invested.

Although financial performance will continue to be of primary importance, and should not be blindly sacrificed for other social issues, there is a balance to be struck. Trustees will need to factor this into their investment deliberations.

The report also recommends that financial regulators build capability so that, as the market develops, social impact is embedded in regulatory frameworks and understanding. Trustees may therefore be facing further regulation. In its second report the Law Commission made similar recommendations, including a new requirement for trustees to report on their policies on evaluating social impact, considering members' ethical concerns and exercising stewardship powers.

Time for proactivity

Trustees should have this issue prominently on their agenda. Although the market is still developing (the need for further regulations on commercial organisations and for work on more closely matching the size of investment packages to that of investor funds being key areas for development) the movement is gathering pace.

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Trustees reluctant to embrace social impact investing might feel more comfortable by considering that investing pension funds to encourage best corporate behaviours and to contribute to social improvements such as new infrastructure will help to ensure that the planet will still provide a comfortable environment in which members can live out their retirement. That would surely be looking after members' interests.