



ESG, easy as 1,2,3:

Practical steps for meeting
increased disclosure requirements

As trillions of dollars flow into sustainable investments and high-carbon assets are written down by oil companies, environmental, social and governance (ESG) themes are influencing investment decisions on an ever-increasing scale and affecting companies' access to capital.

Against this backdrop, pension-fund trustees now face increased regulatory scrutiny about how they take financially material issues into account, including ESG considerations.

Following on from the changes to occupational pension scheme reporting requirements which came into force in October 2019, trustees must review, enhance and publish their statement of investment principles (SIP) by 1 October 2020. Also after 1 October 2020, DC and hybrid schemes are legally obliged to include an implementation statement in their scheme's annual report on the principles outlined in their SIP. Defined benefit (DB) trustees must develop an implementation report on their voting and stewardship policies by 1 October 2021.

The result is that an enhanced layer of oversight now applies to trustees' decision-making processes, from setting out trustees' investment beliefs, to overseeing and reporting on their implementation.

This aim of this document is to support trustees by focusing on three key issues that are likely to emerge during the process:

1. How are schemes managing financially material risks and opportunities, including from ESG issues?
2. To what extent are members' views (on non-financial factors) taken into account?
3. How can trustees better understand and explain the voting and stewardship activities conducted on the scheme's behalf?

In the final section (three) we include a practical selection of LGIM resources to help trustees draft statements to meet the new requirements.



1. Living in a (financially) material world: Managing the risks and opportunities

The regulations coming into force are not necessarily intended to alter schemes' investment decisions. Trustees who are satisfied that ESG issues have been sufficiently covered under existing arrangements for managing material risks and opportunities may wish to state this explicitly in their SIP and implementation statements.

A review published in January 2020 by the UK Sustainable Investment and Finance Association (UKSIF) of large UK pension schemes found that 58% stated in their SIP that ESG factors will be financially material to their investments.¹

LGIM's investment beliefs (#1)

Environmental, social and governance (ESG) factors are financially material. Responsible investing is essential to mitigate risks, unearth investment opportunities and strengthen long-term returns for clients.

The enhanced requirements include oversight of both processes and outcomes. Trustees and their advisors are expected to scrutinise the way in which ESG issues are incorporated as part of the investment process – from asset managers' governance through to their sources of ESG data.

Some trustees wish to target investment outcomes further than existing processes allow – for example, by adopting an investment mandate with an explicit goal of a reduction in associated carbon emissions, or other positive ESG characteristics. This decision may be motivated by considerations of financial risk and return, but it may also reflect members' views on sustainability issues (see the next section).

Regardless of the type of investment mandate they have chosen, trustees should review the stewardship activities – such as voting and engagement with companies and policymakers – undertaken by their designated asset managers.²

LGIM's investment beliefs (#2)

We have a responsibility to effect positive change in the companies and assets in which we invest, and for society as a whole. To us, this means active ownership and engagement through stewardship and cross-asset research.



1. <https://uksif.org/wp-content/uploads/2020/03/UKSIF-SIP-Review-Jan-2020-final.pdf>

2. For more information on updating the SIP, please see: http://www.lgim.com/web_resources/lgim-thought-leadership/Files/Client_Solutions_five_step_esg_checklist_trustees_Mar_19_UMBRELLA.pdf

2. Don't just show me the money: Scheme-member perspectives

The updated regulation also addresses scheme members' non-financial preferences. Here, there are several things to consider: what are members' preferences, where do they want them incorporated, and how? Is the asset manager aware of and incorporating members' views into its investment decisions?

Our research has found that scheme members are increasingly engaged with ESG issues.

In a survey of around 1000 workplace-pension savers which LGIM conducted in 2019, over half of respondents expected companies taking steps to address ESG issues to perform better than those that do not, with 55% expecting their pensions to be less invested by default in ESG laggards.

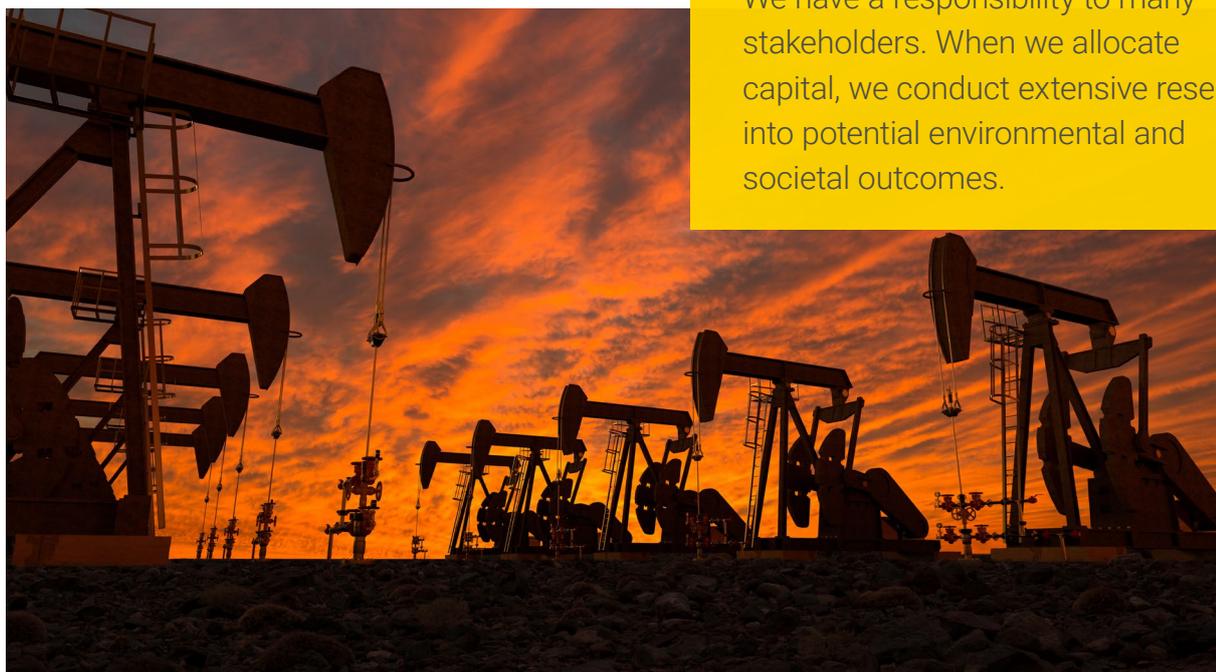
This need not translate into blanket exclusions of entire sectors: nearly half of respondents preferred a

policy of engagement with companies as the first step, with divestment only a method of last resort. This is aligned with the approach taken by LGIM in our Climate Impact Pledge, where voting and investment sanctions are applied against individual companies who fail to keep up with the best practice for their industry, rather than against entire sectors.³

It's encouraging that our research findings included people of all ages affirming that they would engage more with their pensions if they felt that they were making a positive impact.

One such dimension of impact is the positive influence that investors can have on investee companies, and thereby on society as a whole, through their stewardship activities.

More information about LGIM's stewardship activities and other relevant policies can be found below.



LGIM's investment beliefs (#3)

We have a responsibility to many stakeholders. When we allocate capital, we conduct extensive research into potential environmental and societal outcomes.

3. See more: <https://www.lgim.com/uk/ad/insights/our-thinking/market-insights/climate-impact-pledge-tackling-the-climate-emergency/>

3. Hop, SIP and a jump: Resources to support the enhanced disclosure of schemes' stewardship activity

To assist trustees in compiling information and crafting their SIP and implementation statement to

meet the enhanced requirements, we've put together the following list of LGIM-published resources.

a) SIP requirements

Requirement to explain in SIP:	LGIM's approach:
How trustees' arrangements with their asset managers incentivise the managers to align their investment strategy and decisions with the trustees' investment policies.	<p>LGIM invests through active ownership. Active ownership means working with companies, policymakers and other investors to create sustainable value over a long-term horizon</p> <p><u>LGIM's 2020 Active Ownership Report</u></p>
How trustees incentivise the asset manager to make decisions based on assessments of medium to long-term financial and non-financial performance of an issuer of debt or equity, and to engage with issuers in order to improve their performance in the medium to long term.	
An updated stewardship policy which explains how they engage with and monitor investee companies in terms of their capital structure and how actual or potential conflicts of interest are managed.	<p><u>LGIM's Global Corporate Governance and Responsible Investment Principles 2020</u></p> <p><u>LGIM's Engagement Policy: How we integrate shareholder engagement into our investment strategy</u></p> <p><u>UK Stewardship Code Response</u></p> <p>Quarterly ESG Impact Report for clients</p> <p><u>Compiling public ESG Scores to monitor large companies' ESG performance</u></p>
An important item to revisit from 2019: The extent to which members' views on non-financial matters (including ethical views, views in relation to social and environmental impact and present and future quality of life of members and beneficiaries) are taken into account in the selection, retention and realisation of investments.	<p>We have conducted multiple surveys on the ESG views of pension savers – our latest research is available below:</p> <p><u>Our 'Finding the greenest generation' research examines the different attitudes towards ESG issues for three generations of DC pension savers</u></p>

b) Implementation statement requirements

Regulatory requirement/consideration in the implementation statement. ⁴	LGIM's approach:
<p>Build a scheme voting policy and explain how each manager's policy aligns with it. What are the criteria the trustees use to define the "most significant" votes? How do these criteria relate to the voting policy, if any, or to the stewardship or investment strategy and objectives?</p> <p>A description of the managers' rationales for their inclusion of votes as significant.</p>	<p><u>LGIM's Corporate Governance and Responsible Investment Policy UK 2020</u></p>
<p>Provide an overview of the votes cast during the year, e.g. the number of votes available, the number exercised, the number that were cast for and against, and the number of abstentions (votes withheld).</p>	<p><u>LGIM's 2020 voting record</u></p>
<p>Challenging managers on conflicts of interest</p>	<p><u>LGIM's Conflicts of Interest Policy</u></p>
<p>Sign up to collaborative investor engagements.</p>	<p>LGIM regularly takes part in collaborative engagements around the world, including via investor networks such as the UN Principles for Responsible Investment, the Institutional Investor Group on Climate Change, the UK Investor Forum, the Council of Institutional Investors and the Asian Corporate Governance Association.</p> <p>For more information, read:</p> <p><u>Our PRI Transparency Report</u> <u>UK Stewardship Code Response</u> <u>Statement on Investor Stewardship Group's reporting principles</u></p> <p>LGIM's ESG Impact Report details our stewardship and engagement activities</p>

4. Based on requirements listed in the PLSA Implementation Statement Guidance for Trustees: <https://www.plsa.co.uk/Portals/0/Documents/Policy-Documents/2020/PLSA-Implementation-Statement-guidance-for-trustees-July2020.pdf>

Regulatory requirement/consideration in the implementation statement:	LGIM's approach:
A description of the voting process in the scheme or its underlying funds, including to what extent the trustees or managers use the recommendations of proxy voting advisory services to inform their voting decisions.	<p>LGIM uses the recommendations of proxy advisors, but has developed custom voting policies:</p> <p><u>How we use proxy advisers</u></p>
How the way in which the investment arrangements are structured affect trustees' scope and ability to engage with managers and influence managers' voting approaches.	<p>LGIM conducts regular, annual events for clients and stakeholders, inviting feedback on our voting approach. Examples of policies changed or strengthened as a result are detailed in the annual Active Ownership Report.</p>
<p>Pooled funds: if the manager has a securities lending programme, has the manager clearly communicated whether there is a process in place to recall assets out on loan for the purposes of voting, or for any other reason? How do these criteria change, if at all, across geography or size? The extent to which these criteria relate to member views?</p>	<p>In jurisdictions where we operate stock lending, there is a clear process to recall assets out on loan, and all stock lending revenue, less administration costs, is reinvested in the pooled fund for the exclusive benefit of unit holders.</p> <p>For pooled funds, we operate a stock-lending programme in select markets under strict conditions regarding the credit rating of counterparties and the quality and extent of collateral. We have the ability and right of recall at any time in order to vote on important shareholder meetings.</p> <p>In the countries where we lend stock, we will vote on behalf of between 5-15% of the shares held back, unless we recall the stock. In the case of a significant vote we have the capacity to recall all of our votes. The programme is administered by the relevant fund custodians.</p>

There are other resources to assist with your reporting available, including:

- **'PLSA Implementation Statement Guidance for Trustees'**. For more information on trustees' voting disclosure obligations, please consult this guide.
- PLSA voting templates to send to your asset manager for completion
- Template voting policies: for example, the **'PLSA Stewardship Guide and Voting Guidelines 2020'**

Here to help:

In an increasingly stringent regulatory environment, LGIM is playing our part in trying to steer the market towards better practice. In 2020, ShareAction ranked LGIM number three of the world's 75 largest asset managers across responsible investment themes, and as one of only five managers to be placed in the top category (A).⁵

Please do not hesitate to contact your usual relationship manager should you require any further information about any aspect of this guide, or assistance in gathering information to meet regulatory requirements.

5. Source: "Point of No Returns: A ranking of 75 of the world's asset managers approaches to responsible investment", ShareAction, March 2020 (<https://shareaction.org/research-resources/point-of-no-returns/>).



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