C-Suite
Pension Strategies

The Unsustainable ESG Pensions Carve Out

The gap between Board and pension trustee ESG strategies is not sustainable.

Most Corporate Boards treat their defined benefit pension schemes as having a "carve out" from their wider ESG commitments.

By helping trustees reset their thinking from "get rid ASAP" to Run On 4 Good to benefit all stakeholders, Boards avoid greenwashing and create ESG Flagships.

Run On 4 Good

Introducing C-Suite's ESG Flagship Initiatives

Corporate Rhetoric on ESG

Chair and Chief Executive statements in Annual Financial Statements, in Sustainability Reports and in Section 172 Statements are clear on the corporate ethos and ESG commitments. Rare indeed for the pension scheme to be addressed. Yet the scheme's trustees are making major investment decisions and the purpose of the scheme itself is to look after employees.

SustainAgility
FOSTERING POSITIVE CHANGES

A positive force for a more sustainable industry

That's SustainAgility™ – it goes to the heart of who we are and what we are as a business, now and well into the future.

"Sustainability has become integral to our business culture. Our ESG strategy looks beyond reducing negative impact to positively impacting the environment through our operations."

RESPONSIBILITY

Doing What We Do – For Those Who Make The World™

Operating in a sustainable way and being a force for good is a great responsibility.

Our strong ESG approach underpins all we do

We are achieving our social value goals and creating a better world at work for our planet by ensuring sustainable practices are front and centre of all the decisions we make.

OUR NET-ZERO JOURNEY

Our industry-leading net-zero pledge includes scope 1, 2 and 3 targets, validated by the Science Based Targets initiative (SBTi). Addressing both direct and indirect impacts, these objectives will guide our low-carbon strategy for decades to come.

Sustainability is now integral to our corporate strategy.

WE'RE COMMITTED TO BUILDING A BETTER PLANET

Tackling climate change is core to our purpose as a firm

Corporate Responsibility. We conduct our business with the highest standards of integrity.

Sustainability at the heart of our strategy

We are committed to fostering an environment where we maintain high ethical standards in everything we do. We conduct ourselves professionally, transparently and run our business with integrity. Striving to do the right thing is embedded within our culture.

Doing what's right

Our Code is our guide for making decisions that reflect our values and who we are as a company.

Deepening trust

We work to preserve the trust people place in us and do what's best for our customers, stakeholders, and the community.

A Global Leader in Sustainable, Eco-Efficient Business Practices

Our Environment, Social and Governance impact

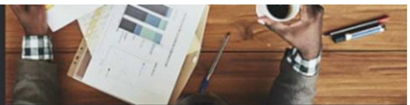
> For us, social value is not something we simply pay lip service to. It is part of our DNA, completely embedded in everything we do."

Supporting Our People

The cost-of-living crisis has made things tough not just for businesses but for so many individuals across the country. People and culture are at the heart of our strategy, and we wanted to do all we could to support our teams through difficult times they may have been experiencing outside of work.

We care about our people

Our purpose



Our purpose is at the centre of everything we do

"Guided by our purpose, we're helping to turn business commitments into real action on climate change and inequality."

ESG - Living our purpose

Our ambition is to build trust in the climate transition and help accelerate the transformation the world needs.

Purpose sits at the heart of our strategy and integrating the fundamentals of ESG into our work is key to helping organisations improve their impact on the environment, and on society, to become more resilient, agile and sustainable. We're launching an ESG platform and committing to upskill our people to build ESG into our client services, which is part of our global net zero commitment.

Pension ESG Reality: Coming to Light

Meanwhile the tone and direction of the strategic plans of DB scheme trustees is completely different. Obtaining cover for accrued benefits from a life insurer is what matters most. The Statements of Investment Principles and Statement of Funding Principles are about investment derisking ASAP. Time is short so ESG is not the issue. Net zero does not score highly as a live issue in a Death Wish SIP. The lack of alignment is showing up.

Make My Money Matter partnered with Route2 and Scottish Widows to produce a research paper on the 'Untapped Power of Corporate Pensions'

Route2 | Make My Money Matter | SCOTTISH WIDOWS

FTSE100 Pensions Emissions

An analysis of the untapped power of corporate pensions

September 2022

"The UK pensions industry is worth £3 trillion, with £20 billion invested each year into pensions by UK businesses and their employees.

Yet a lack of awareness, poor transparency and a passive approach to pensions means that from a sustainability perspective they remain marginalised; on the periphery of CEO decision making and at arms' length from corporate sustainability initiatives.

….the money in corporate pensions is often invested in ways that not only jeopardise our futures, but also <u>undermine the values, commitments, and sustainability strategies of those same businesses</u>."

"By ignoring their pensions, businesses are scratching the surface of their environmental impact; often focussing on the low hanging fruit but failing to address the urgent, unreported, and systemic impacts of their money."

Richard Curtis, Co-Founder at Make My Money Matter

"This report leaves us in no doubt - pensions are one of the most powerful tools UK businesses have to tackle the climate emergency. But for too long, businesses have failed to capitalise on this opportunity - company pensions now finance a staggering 7 times more carbon than the emissions produced by those same businesses. For organisations to be acting credibly and decisively on climate, green pensions must be a crucial part of their plans.

"We hope this report acts as an urgent wake-up call and puts company pensions - and the billions invested by them each year - at the heart of all organisations' sustainability strategies."

Industry Discussions

Pension scheme strategies and responsible investment are major current talking points. The LDI crisis led to HM Treasury re-engaging more clearly on pension funding. Pension investment once was a key factor in driving investment in the UK economy. It could be again. The Chancellor reset the agenda at Mansion House and the pension sectors major consultancies and representative bodies are scrabbling to catch up.

A "lightbulb moment" from Aaron Punwani of LCP

LCP are a leading actuarial consultancy, perhaps recently best known for pushing Risk Transfer projects effectively.

Now it has an active wing keen on running on. Its chief executive has had a light bulb moment and identified a Guilty Secret. The inconvenient truth is that ESG has little meaningful role in the industry's core strategies and products. Trustees are turned off by the compliance reporting.

PROFESSIONAL PENSIONS SUSTAINABLE INVESTMENT HUB

Aaron Punwani: The guilty reality of pension scheme action on climate change

Aaron Punwani: My lightbulb moment on responsible investment

By now, most people in the pensions industry accept that a climate emergency is looming, and that mitigating the risk of catastrophic events requires a massive redeployment of capital.
UK pension fund trustees and their advisers have also been inundated with regulatory requirements to consider climate change; to have regard to the impact of climate risk in making decisions; and to report that they have done so.
But the guilty reality is that, for the large majority of UK pension assets - the £1trn plus held by closed defined benefit (DB) schemes - the dots are not being joined."

PLSA Annual Conference in October 2023:

Government representation and discussion on pension schemes playing a key role in facilitating UK growth.

Speakers

Andrew Griffith MP
Economic Secretary to the Treasury and City Minister

Information

We hear about the Government's ambitions to encourage pension schemes to invest in illiquids, sustainable assets and UK growth. What actions have they already taken, and what further action they plan to take.

Chartered Institute for Securities and Investment Event

Major event hosted by Willis Towers Watson featuring top industry experts to discuss the 'avoidable' LDI crisis of Autumn 2022 and lessons learned for future advice.

At the session, DB pension fund "decommissioning" will emerge as a major 21st century policy disaster.

CISI
CHARTERED INSTITUTE FOR
SECURITIES & INVESTMENT

Learning objective

During this session: To understand more about how the origins of the pensions crisis of the past six months, how it unfolded, and what the lessons

Managing risk, embracing uncertainty, in pensions

Pensions has been one of the biggest avoidable public policy crises in our generation; the problems came to a head in last autumn's bond market turmoil around LDIs.

In this major event, featuring experts such as economist Professor Sir John Kay, former Bank of England Governor Lord (Mervyn King), and former Pensions Minister and now LCP Partner Sir Steve Webb – plus a host of others, a dozen speakers in all – we will probe the future for one of the most important financial assets in most of our clients' lives.

Typical Pension Trustee ESG Considerations are Short Termist

The Statement of Investment Principles (SIP) structures in short timeframe. They are the source of the anti ESG framework. The language of derisking is all pervasive. Journey plans tie in with Endgame Solutions. The first page of most SIPs sets a framework which largely writes out the environmental and the societal. It can make the remainder of the SIP a box ticking exercise. ESG is ever more resented by trustees and advisors as irrelevant and time consuming.

2.2 The Trustee's investment policy has been established through a Journey Plan in conjunction with a Dynamic De-risking Strategy with a specified funding level objective and time horizon. The Dynamic De-risking Strategy and Journey Plan are statements of current investment strategy put in place by the Trustee and are reviewed in consultation with the Principal Employer from time to time. The investment return objective implicit in the Journey Plan changes over time and may not necessarily reflect the Dynamic De-risking Strategy on occasions.

2.3 The Trustee has agreed to a long-term objective, that is to be fully funded (currently defined as full funding on a Gilts+0% basis) with the aim of reaching full funding by 2030. This objective is consistent with the long-term assumptions of the Trustee in determining the funding of the Plan. In accordance with the Dynamic De-risking Strategy, the Fiduciary Manager will de-risk the Plan's assets as the funding level improves.

6. Responsible Investment and Corporate Governance

The Trustee believes that environmental, social and corporate governance ("ESG") factors may have a material impact on investment risk and return outcomes. The Trustee also recognises that long-term sustainability issues, including climate change, present risks and opportunities that increasingly require explicit consideration. Details on how these are considered are set out in separately in the Trustee's ESG Beliefs Statement which is included in the IPID. The Trustee has taken into account the expected lifetime of the Plan when considering how to integrate these issues into the investment decision making process.

Having considered its fiduciary duty, the Trustee has delegated the evaluation of ESG factors, including climate change considerations, and exercising voting rights and stewardship obligations (including engagement activities) attached to the investments, to the appointed investment managers in accordance with their own corporate governance policies and current best practice, including the UK Corporate Governance Code and the UK Stewardship Code.

The Trustee considers how ESG, climate change and stewardship is integrated within investment processes when appointing new managers and monitoring existing managers. These issues are monitored by the Trustee, which takes advice from Mercer's assessment of how the fund managers incorporate ESG into their investment processes. Monitoring is undertaken on a regular basis and is documented at least annually to assess the effectiveness of applied approaches.

2. <u>Investment Objectives of the Sections</u>

The Trustee's primary objective is to ensure that the assets of the Plan are sufficient to meet its obligations to beneficiaries. The most objective measure of the Plan's ability to pay members' benefits is the ratio of assets to the liabilities measured on a 'low risk' basis. The Trustee's primary aim can, therefore, be translated into a desire to avoid deterioration of the low risk funding level

The long term target for these purposes is defined as 105% funded status on a Gilts + 0.25% p.a. valuation basis.

3. Investment Strategy

3.1 The Trustee has agreed a Journey Plan for the Plan, taking into account an Integrated Risk Management ("IRM") framework, having taken advice from its covenant, actuarial and investment advisers.

3.2 Underpinning the Journey Plan is the objective of ultimately removing all sponsor reliance by 2027.

Investment objectives

The Trustee invests the assets of the Scheme with the primary objective of ensuring that all members' accrued benefits can be paid. The Scheme's funding target is specified in the Statement of Funding Principles. The Scheme's funding position will be reviewed on an ongoing basis to assess the position relative to the funding target and whether the investment arrangements remain appropriate to the Scheme's circumstances.

The Scheme's present investment objective is to achieve a return of approximately 1.5% per annum above the return on 10-year UK Government gilt yield.

Appendix A – Investment Objectives

1. Target funding objective (time, basis)

Self-sufficiency on Gilts + 0.5% and use insurance market as opportunities arise.
Target to achieve this by 2025 – 2030.

2. Level of risk to take

Take a low level of risk to achieve objective by utilising contractual assets and giving up extreme upside for downside protection.

3. Long term exit plan

Low risk self-sufficiency, leading to:
Securing some or all of the pensions with an insurance company.

d. The targeted asset performance is consistent with the agreed Targeted Rate of Investment Return (see Section 6.2) and the Scheme's Statement of Funding Principles adopted pursuant to Section 223 of the Pensions Act 2004:

i. The Technical Provisions adopt a discount rate of Gilts plus 0.75% p.a.,

ii. The Trustee and the Company have agreed an additional funding objective, which is for the Scheme to have sufficient and appropriate assets to cover its liabilities on the Long Term Objective ("LTO") basis by 31 March 2030. The LTO adopts a discount rate of Gilts plus 0.50% p.a.,

iii. Whilst the additional funding objective is to reach full funding on the LTO basis by 31 March 2030, the Trustee and the Company expect, based on the funding position and market conditions as at 31 March 2021 and if all assumptions are borne out, to achieve this by 31 March 2027 as a result of:

I. targeting additional asset returns in excess of the discount rate (at such levels to be agreed between the Trustee and the Company from time to time – see Section 6.2);

II. additional contributions received following the disposal of IMServ Europe Limited, a participating employer in the Scheme; and

III. the release of prudence over time.

Past and Present Employees Response

Employees have been remarkably passive on pensions. Schemes closed to new members and future accrual. Little resistance. DC schemes were clearly less generous. Little response. Share Action and Make My Money Matter now provide activism.

BP pension scheme members have set up an action group to request discretionary increases. They set it firmly within an ESG context.

Inflation and the cost of living crisis are changing attitudes. Requests for above 5% increases have been blocked by sponsor. Surpluses are arising with interest rate increases. How to use them to improve DC pensions are consultations and legislation away.

Better questions from employees on what is the package of proposals to which sponsors say yes would help close the ESG gap.

Intergenerational unfairness is addressable.

The Mood Music is Changing

Source documents

- Life insurers: concentration and business practice risks – Charlotte Gerken speech April 2023: https://www.bis.org/review/r230427g.pdf
- The Blair Institute: Causes of decline of British pension provision: https://www.institute.global/insights/economic-prosperity/investing-in-the-future-boosting-savings-and-prosperity-for-the-uk
- Peel Hunt : Reinvigorating the UK Equity Market: https://www.peelhunt.com/media/pheh1pii/uk-equities-final.pdf
- LCP : The guilty reality of pension scheme action on climate change https://www.professionalpensions.com/opinion/4123823/aaron-punwani-guilty-reality-pension-scheme-action-climate-change

ESG Flagships Replace Endgames

Group Boards and head office teams committed to an ESG agenda should end the DB pension policy endgame. Turning a blind eye to the settled "get rid" policy of trustees and their consultants risks becoming a subset of greenwashing.

With all Group functions inputting (ESG, Human Resources, Risk and Compliance, Investor Relations, Internal Communication; as well as finance and pensions) better, modernised plans emerge based on Run On 4 Good.

C-Suite has developed exciting, immediately deliverable Flagship ESG strategies and products. They eliminate the need for a carve out and close the gap between rhetoric and reality.

Components can be:

E	▪ Long term, stable investment strategies with growing "productive asset" allocations when appropriate funding level allows. ▪ Pension assets included in net zero story. ▪ Growing new (Collective) Defined Contribution tier with high growth asset level.
S	▪ Surpluses directed to funding current employee pension provision with focus on intergenerational fairness. ▪ Discretion used to add temporarily to current pensions in payment. ▪ Asset allocation to "impact" and community Place Based projects and investment where the business operates.
G	▪ Trustees' concerns about covenant risk and admin hassle addressed. ▪ Trustees' remit reset to achieve long term engagement and involve employees past and present in real decision making.

Fiduciary Management Plus (FM+) is a solution developed with Van Lanschot Kempen that allows corporate sponsors and trustees alike to align their pension assets with their ESG vision.

Please get in touch to discuss how this could work for your scheme.

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