

Pensions and ESG: Institutional and Historical Perspective

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Responsible Investing, Sustainable Investing, ESG Investing, etc.

“Strategy and practice to incorporate environmental, social and governance (ESG) factors in investment decisions and active ownership”

United Nations Principles of Responsible Investing (2021).

Descriptive framework

- **Universal owner:** A pension or another institution that by intention or requirement invests long-term in widely diversified holdings throughout the global economy. (Urwin 2011)
 - **Externalities.** Who's affected? What incentives to act?
 - **Agency.** Sounds good in theory, but who pays and who benefits?
- **ESG drivers**
 - Economic transformation
 - Rise of universal owners (new categories of large institutional investors):
 - Stakeholder interests, not just shareholders
 - Improved data and analysis of causes, effects and policies
- **Modern era evolutionary emphasis**

1970s	Principles
1980s & 90s	Products
2000s	Processes
2010s	Outcomes
2020s	System

Pre-modern era

Characterized by

- Concentrated ownership of public companies
- Transformation of work and consumption
- Little to no small shareholder activism on social or environmental issues
- Little to no pension activism

Mostly governance related

- Policies to limit bank & family ownership and monopolies: antitrust; separate commercial and investment banking; shareclass reform.
- 2-tier board structure
- First uniform accounting, reporting, disclosure rules
- First formal recognition of stakeholder rights (Germany)
- Government ownership or control of certain industries (pre-WWII Japan, Soviet Union; post-WWII, esp U.K., France, Italy, China)

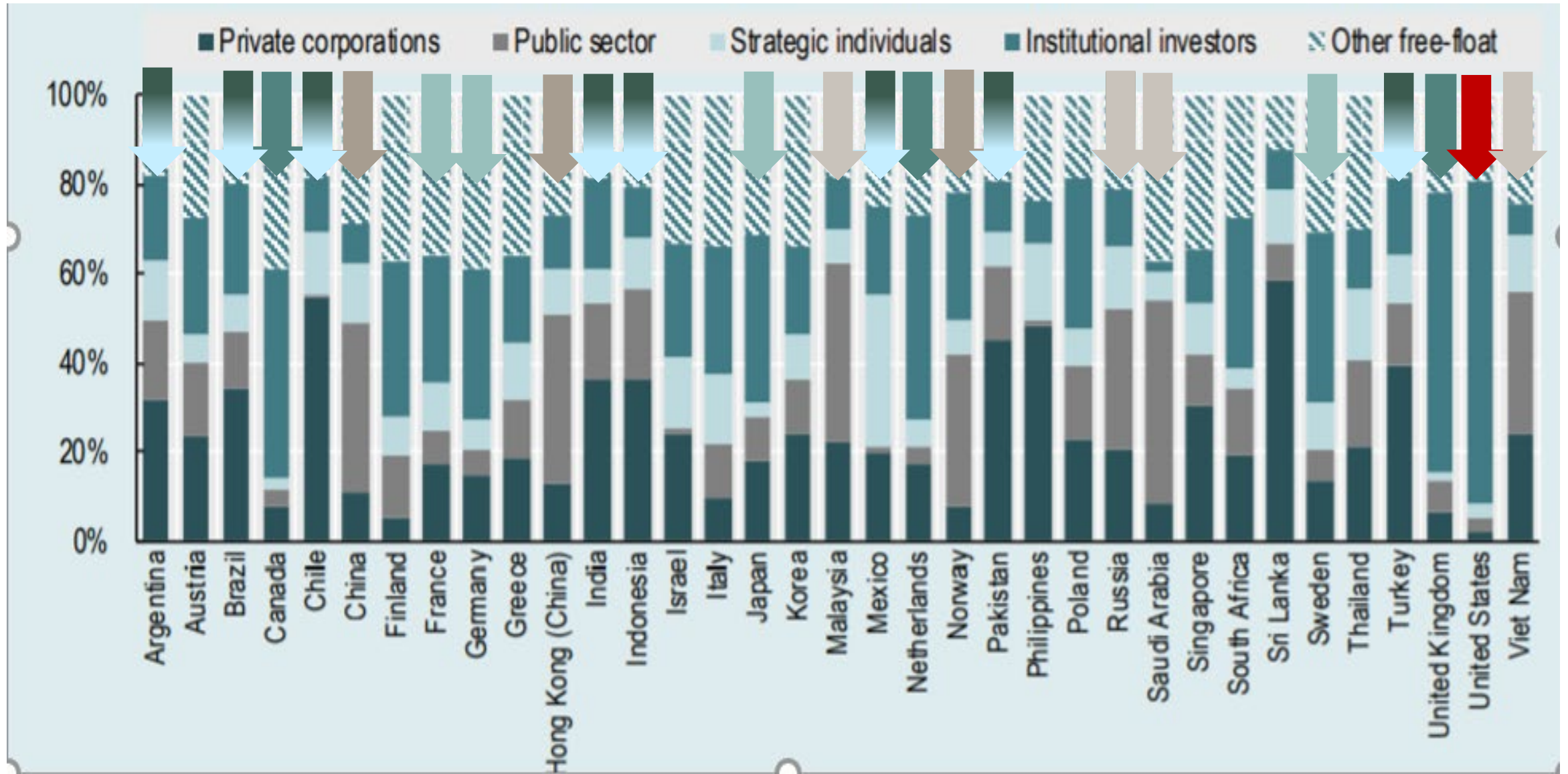
Other: Regulation of hours, working conditions, food quality, other products & services; environmental movement (U.S—Rachel Carson)

Dawn of the modern era of ESG (roughly 1970)

ESG vary by country,

- **G:** Governance policies and practices vary by country
 - In the U.S., company management dominant
 - In some European countries, family and/or bank control. In others, government ownership (or both)
 - In Japan, cross-holdings and bank influence
- **S:**
 - In the U.S., U.K., contention over social issues; declining influence of unions
 - In Europe, contention over social issues
- **E:**
 - In the U.S., environmental movement takes off
 - Little interest outside the U.S. in environmental issues

Share holding patterns vary by country



Source: De La Cruz et al. (2019) based on OECD Capital Markets Data Set, Thompson Reuters and Bloomberg.

Modern Era: ESG emergence as a “system”

1970s – 2020s evolution

- **E, S & G initially treated separately**
 - Governance: focus on principles, rules, process to produce good behavior
 - E&S: focus on reducing harm
 - E&S thought of as “complex” compared to G
- **Ecosystem**
 - Social movements
 - Government/regulators
 - Independent advocacy and service organizations
 - Asset owners
 - Asset managers

Evolution of ESG Investing



1970s

“ESG as a principle”

- Investors align around key social concerns (i.e. South Africa, Vietnam War)
- Pioneering institutions are created (IRRC, ICCR)



1980s

“ESG as a product”

- Dedicated industry networks are formed (Ceres, USSIF)
- Increased emphasis on corporate governance and the environment



1990s

“RI as a product”

- First social indices launched and universe of Socially Responsible Investing (SRI) funds expands
- Advance business case for sustainability and reporting (i.e. GRI)



2000s

“ESG as a process”

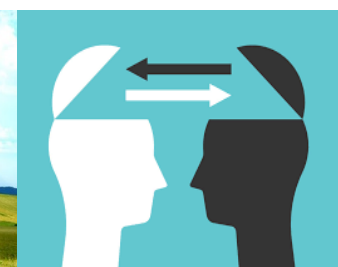
- Investor convergence on climate issues
- Global investor networks formed (i.e. PRI, Global Impact Investing Network)



2010s

“ESG as an outcome”

- RI approaches expand across asset classes
- Expansion of ESG data and reporting to better quantify ESG factors
- Greater focus on outcomes (i.e. UN SDGs)



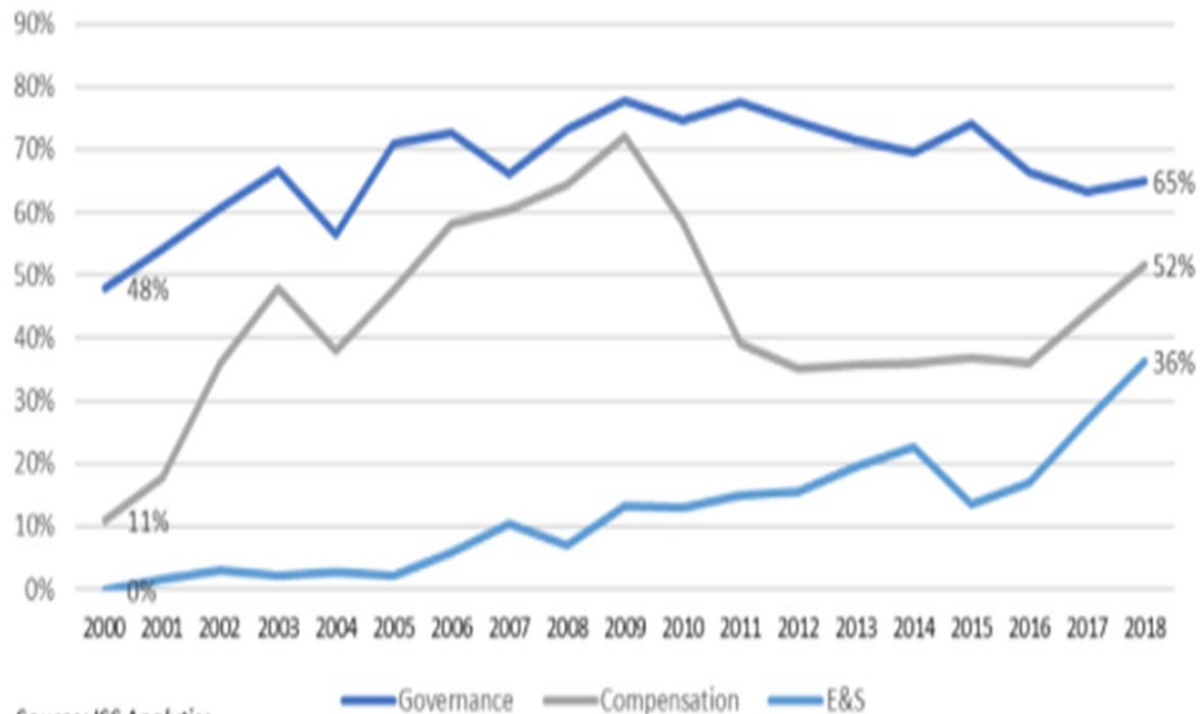
2020s

“ESG as a system”

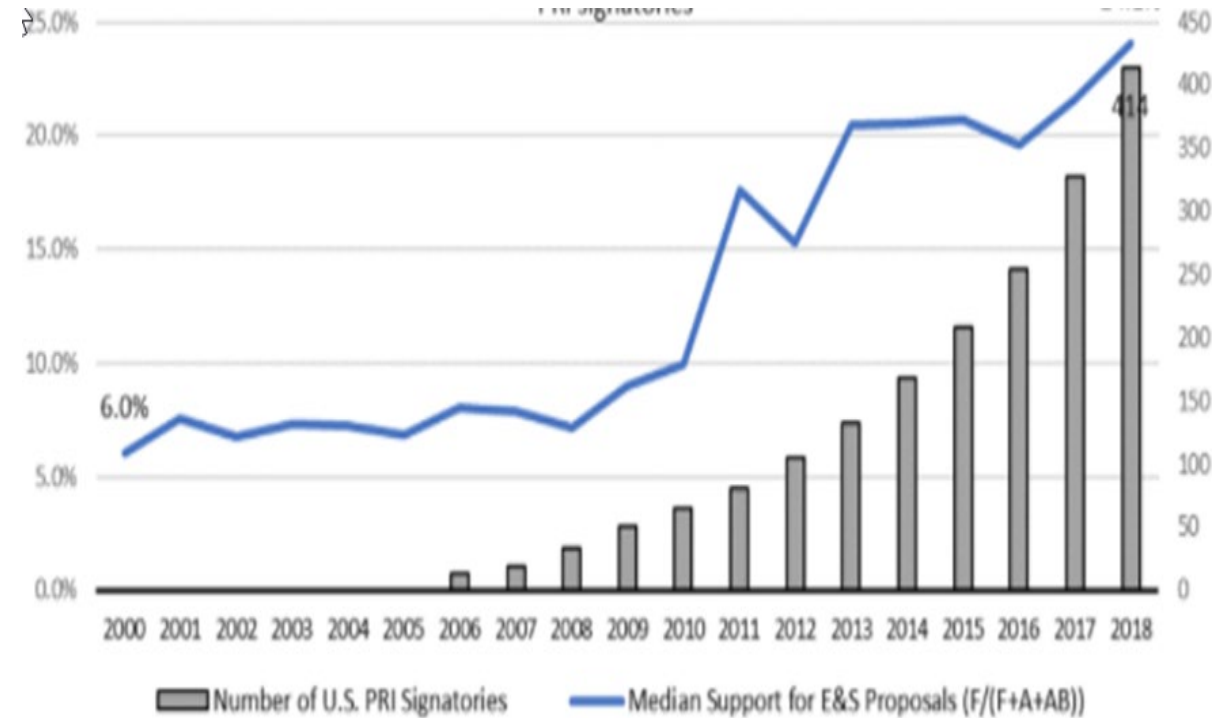
- Institutional investors go “all-ESG”
- Attention to S from COVID and equality issues
- Scrutiny and regulation to combat greenwashing
- Heightened urgency around climate change

E & S issues are joining the mainstream among shareholders

Percentage of shareholder proposals by category receiving >30% of votes cast



Median support for E & S shareholder proposals (left scale) and # of UN PRI signatories in the U.S. (right scale)



Notes:

1. Does not measure # or growth of shareholder initiatives
2. Scales in two figures are different

Continuing Challenges

- **Does further ESG progress require all investors to be on the same page?**
 - Motivations for investors' participation in ESG are quite diverse
- **Who will make decisions about:**
 - Prioritizing stakeholders and beneficial real-world outcomes
 - What ESG data companies should be required to disclose;
 - How investors analyze ESG data (e.g., what makes a company an ESG leader or laggard);
 - Investment and engagement decisions
- **Who “owns” the big picture?**
 - UN PRI; E.U.; SEC/DoL; rating “agencies”; pensions; other institutional investors
 - Is the creation of an effective (& global) investment industry ESG ecosystem our only hope for continued evolution?
 - Which market participants (and stakeholders) win and which lose in that future state?
- **What's the next unifying issue after climate change?**
 - Equality?