The Origins of ESG in Pensions: Strategies and Outcomes

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Structure

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Motivation

• In March 2020 – the leaders of three of the largest pension funds world-wide: the California State Teachers’ Retirement System (CalSTRS), the Japanese Government Pension Investment Fund (GPIF), and UK Universities Superannuation Scheme (USS) make a public statement, in which they outline that:

  ‘if we were to focus purely on the short-term returns, we would be ignoring potentially catastrophic systemic risks to our portfolio’ and underlining how ‘asset managers that only focus on short-term, explicitly financial measures, and ignore longer-term sustainability-related risks and opportunities are not attractive partners for us’.

• In November 2020 – the CEOs of the eight largest Canadian pension funds – the so-called ‘Maple 8’ – make a public pledge about their commitment to:

  ‘creating more sustainable and inclusive growth by integrating environmental, social and governance (ESG) factors into our strategies and investment decisions.’ Stating that this ‘is not only the right thing to do, [but] is an integral part of our duty to contributors and beneficiaries [which] will unlock opportunities […] and deliver long-term risk-adjusted returns.’
Questions

→ What are the social origins of ESG in pensions?

→ In other words, which historical, organizational and contextual characteristics of pension funds naturally enable and / or inherently inhibit the consideration of E, S and G issues in their investments?

→ How does this influence their ESG strategies and behavioral outcomes?
Literature Review

PENSION FUNDS & ESG / SUSTAINABLE FINANCE

Vast and growing literature – picking concepts that seem to answer questions about the structural constitution of pension funds

Pension Funds as UNIVERSAL OWNERS

• Large diversified institutional investors with long-term investment horizon
• No “diversifying away” from systemic risk (such as climate change and income inequality)
• Need for system-level lens and “asset owner” alliances to push this thinking through the investment chain

Pension Funds between PUBLIC AND PRIVATE INTEREST

• Pension funds, particularly public ones, can be caught facing dual tensions:
  o Having to address questions of public interest (which their beneficiaries increasingly push them to) on the one hand, and
  o delivering on long-term financial performance (not uncommonly facing deficits)

Pension Funds’ LEGAL STRUCTURE

• Institutional design defined by
  o Intergenerational mandates
  o Special legal constraints
  o Interpretation of fiduciary duty
  o Heightened expectations around accountability and transparency
Social Origins and Characteristics of Pensions

- Historical origins of pension funds and regulatory embeddedness
- Mandate and legal structure of pension funds
  - Corporate governance and leadership
  - Investment strategy and asset mix
- Collaboration and Advocacy
The Public Sector Pension Investment Board (PSP Investments) is a Canadian Crown corporation created in 1999 with the exclusive mandate to invest funds for the pension plans of the Public Service, the Canadian Forces, the Royal Canadian Mounted Police and the Reserve Force, in the best interests of contributors and beneficiaries.
ESG issues are some of the most significant drivers of change in the world today, with major implications for businesses and long-term investors.

PSP’s investment belief: identifying, monitoring and capitalizing on ESG factors is material to long-term investment performance

- ESG enablers:
  - Board and Management leadership
  - Governance
  - Long-term investment mandate and asset mix

- ESG inhibitor:
  - ESG integration in investment models

- Key to the success: Access to consistent and complete ESG information
Discussion

- Pension funds are not a homogenous group
  - Different mandates, different legal environments, different governance structures to work with

- Still, common objective:
  - Identify the best investment strategy to deliver long-term investment returns for beneficiaries

- We identify how this supports ESG, but also, how challenges remain.
- Some key levers for whether ESG is further supported or inhibited in pensions are:
  - Governance and Leadership of Funds
  - Regulatory clarity on how to integrate ESG
  - Clarity and guidance from plan sponsors
  - Collaboration of pension funds to enable ESG throughout the chain
  - Advocacy and voice of pension funds in favour of ESG