Impact Investing
– Good Governance Principles for Pension Trustees

The Impact Investing Institute has designed this set of Principles for Impact Investing for pension trustees as a practical guide to help them better understand their duties - and options - in our changing world.

The Principles and recommended actions are based on analysis of existing law and regulation in a legal paper commissioned by the Institute and produced by five City law firms.[1] The paper sheds light on the compatibility of Trustees' investment duties and impact investing **– *in other words, why and how Trustees might invest with the intention to generate positive, measurable social and environmental impact alongside a financial return*.**

The Principles are currently in draft form and we are seeking your feedback. Please note that the full Principles will have accompanying descriptions and recommended actions. Your thoughts on the key points these should cover are welcome.

Please share any comments or feedback you have on any aspect of the draft Principles with Bella Landymore, Policy Director at the Impact Investing Institute, at bella.landymore@impactinvest.org.uk.

Initial questions to guide review / discussion
1. Are these the right Principles? 2. Is the document pitched in a way that is compelling for trustees? 3. Can you provide some examples we can use to bring the Principles to life? 4. What approach would you take to consulting on these? Who would you involve at what stage? How would you encourage endorsement; e.g. in the style of a charter, or best practice?

[1] The paper was written by Bates Wells and Sackers, with the assistance of Herbert Smith Freehills, Norton Rose Fulbright and Travers Smith; all firms are members of the Impact Investing Institute's Legal Panel.

Executive summary

Pension scheme trustees (Trustees) have an obligation to use their powers to achieve the pension scheme's purpose - to provide retirement benefits for its members. Increasingly, investment professionals are aware of risks to financial returns that arise from weaknesses in companies' approach to our environment, social responsibility and governance (ESG risks). Those risks must be considered in relation to the time horizon of the pension portfolios, which can be measured in decades. Many companies, for example, now have a significant risk exposure to the transition to a low-carbon economy. Social issues, including diversity and inclusion, workforce protections, and health and wellbeing can also impact the long-term success of an investee company.

Fiduciary duty and a growing body of regulation therefore compel Trustees to consider the implications of exposure to ESG risks in their schemes' portfolios. But there also is opportunity in a changing, and challenged, world. Trustees, in their fiduciary role, are entitled to consider investments that contribute to *solutions* to the challenges the world faces – in other words, that have an impact, by generating positive change for people or the planet.

Impact investing refers to investments:

> "*. . . made with the intention to generate positive, measurable social and environmental impact alongside a financial return.*"[2]

This includes a wide range of investments in companies, funds or other products which meet impact reporting and accountability criteria, and spans asset classes – from listed equity or debt, including green, social and sustainability bonds, to private markets and private equity/venture capital.

Of course, as with any investment decision, it must be consistent with the Trustee's legal duties and support the objectives of their investment portfolio. That support may be a competitive return, but may also be mitigation of risk through diversification, provision of income, reduced volatility, or a number of other features that contribute to an efficient portfolio.

Trustees with fiduciary duties in the UK and throughout the world are finding competitive investments across a range of sectors and asset classes that provide capital growth, income or diversification as well as a positive impact. Hence, there can be sound financial reasons for making impact investments. They can both contribute to the sustainability and resilience of people and planet and increase prospects for long-term capital growth and performance over time.

[2] GIIN (Global Impact Investing Network), https://thegiin.org/impact-investing/

Illustration:

Impact	Example investments	SDG
Products and services which contribute to a net-zero economy and other environmental objectives	• Renewable energy • Waste treatment and recycling • Forestry	✓ SDG 7 – Affordable clean energy ✓ SDG 12 – Responsible production and consumption ✓ SDG 13 – Climate action
Businesses which are diverse and inclusive by nature or design and provide workers with decent employment, economic opportunities and working conditions	• Locally based SME financing • PLCs with leading environmental, social and governance practices	✓ SDG 5 – Gender Equality ✓ SDG 8 – Decent Work and Economic Growth ✓ SDG 10 – Reduced Inequalities
Infrastructure which meets the needs of lower income and vulnerable people	• Social housing • Supported living • Care homes	✓ SDG 1 – No poverty ✓ SDG 11 – Sustainable cities and communities
Technologies which increase agricultural output or provide improved food supply	• AgTech – such as smart irrigation and biowaste • Farming equipment	✓ SDG 2 – Zero Hunger
Foods and other products which improve health and nutrition	• Health food enterprises • Sustainable fisheries	✓ SDG 3 – Good Health and Well-being
Digital and other technologies which increase literacy, language skills, financial inclusion and education	• Education technology ('ed tech')	✓ SDG 4 –Quality Education

The pandemic and global protests against racial inequality have further highlighted the clear and urgent need for change. Going back to business as usual would be the wrong choice – we need a more resilient, inclusive society that will withstand systemic global shocks and share benefits more equally. Environmental and social impacts can be material to a company's ability to create financial value. The view to the future therefore needs to include how investors, through their capital allocation choices, can contribute to building a better, more sustainable world. This includes expectations about the role of big pools of capital such as UK pension schemes.

The societal pressure to meet these expectations is further bolstered by regulatory developments, which in the UK include:

- requirements for Trustees to include policies in relation to financially material ESG considerations; stewardship and engagement activities with investee companies; and arrangements with asset managers – including on ESG issues;
- requirements for Trustees to publish an implementation report, including how they have acted on the policies outlined above;
- enhanced requirements in the Financial Reporting Council's 2020 Stewardship Code for asset owners to report on their stewardship activities and outcomes, including how they take account of material ESG factors; and
- provisions in the Pensions Schemes Bill requiring schemes to publish climate change related risk information and to have governance in place to manage those risks.

We have designed the Principles to help Trustees navigate and respond to these societal and regulatory expectations.

Professional advice can help provide guidance. Once Trustee boards have clarity on their investment beliefs, investment principles and approach to sustainability, Trustees should ask their investment consultants and managers to articulate their approach to addressing ESG issues and impact and ensure that they deliver to the expectations of the Trustees.

We hope the Principles will assist Trustees in understanding the opportunity presented by impact investing and give them the confidence to explore implementing impact investment objectives and practices as part of their approach to sustainable investing.

The Five Principles for Impact Investing

1. **Adopt a 'transitional mindset':** manage the risks and seize the opportunities presented by the move towards a net zero economy, and other major societal transitions.
2. **Set impactful objectives:** establish and incorporate 'impact objectives' as part of your pension scheme's statement of investment principles (SIPs), which draw on the views of your members and are calculated to serve the scheme's purpose.
3. **Appoint investment consultants and managers with impact integrity:** identify and appoint investment consultants who are aligned with your investment beliefs and objectives, and investment managers who can achieve your scheme's impact objectives through their investment and stewardship activities.
4. **Use your voice to make change:** progress your impact objectives by formulating stewardship guidelines for your, or your investment manager's, voting and engagement activities.
5. **Manage and review your impact:** monitor progress against your impact objectives by identifying relevant indicators and benchmarks, assisted by your investment managers.

Adopting the Principles

What are the Principles for?

These Principles are a practical guide to help Trustees understand how to develop an impact investment strategy and how any such strategy should fit into their overall governance framework.

Who are the Principles for?

The Principles are designed for Trustees of trust-based occupational pension schemes, both defined benefit (DB) and defined contribution (DC). However, they are intended to be of universal application by pension schemes and it may be that different types of pension schemes will wish to adapt the Principles to reflect their contexts.

They should serve as a guide to support ongoing reflection and improvement in governance. We recommend that Trustee boards reflect on the Principles periodically as part of the SIP review and annual reporting cycle.

How do the Principles work?

The Principles are sector-led and voluntary, setting out good governance guidelines and recommended practices. They are based upon and informed by legal principles, including in particular the fiduciary duty of Trustees.

Each principle has a brief description, an explanation of the underlying logic and suggested practices to implement the principle.

Whilst Trustees should take their own legal and investment advice as it applies to the circumstances of their own pension scheme, we hope the Principles give Trustees greater confidence to develop an impact investment strategy in compliance with high standards of governance and legal duties.

We look forward to engaging with you on the Principles, developing the list of recommended actions for each, and identifying best in class examples based on our consultation with a wide group of stakeholders.