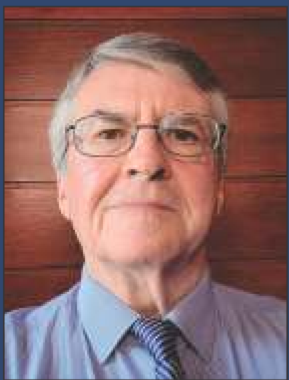
Are your retirement fund's ESG strategies sustainable?



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ESG, sustainable and impact investing practices and standards are continuously evolving, making it challenging to keep up with their fast changing appearance. This article highlights 10 crucial areas for retirement funds to explore and assess how their investment policies and practices in this field stack up, while also providing some ideas for staying at the leading edge.

Understanding fiduciary duty

In recent years, the concept of fiduciary duty has undergone a shift. Alongside risk and opportunity, a third consideration has gained prominence in investment decision making - impact. Trustees, in fulfilling their fiduciary duties, must go beyond traditional risk and return analysis and address the social and environmental impact of their investment decisions, both positive and negative.

There are solid economic reasons for this shift. Global warming has brought the long term sustainability of assets to the forefront and it is now recognised that the sustainability of retirement funds depends, in part, on systemic environmental and social factors that cannot be ignored. Disregarding the bigger picture diminishes overall returns, ultimately affecting individual outcomes.

Additionally, these systemic factors impact on the quality of life that beneficiaries can expect in the world they will retire into. A modern understanding of fiduciary duty unavoidably means addressing facts like climate change, social inequality and economic development. Aiming to generate beneficial social and environmental results without compromising returns, influences the types of investments funds should make.

Checking the ESG alignment of asset consultants and managers

Trustees discharge their fiduciary duties through asset consultants and asset managers while retaining overall responsibility and oversight. It is essential for trustees to ensure that these service providers are well aligned through carefully designed procedures for selection, monitoring, receiving advice and reporting.

Investment mandates and other contracts are important. Asset consultants and asset managers must have a clear understanding of the role that ESG factors and impact considerations should play in investment strategy and decisions. Establishing a common understanding of a fund's fiduciary duty in this area is critical.

Integrating ESG with strategic asset allocation

ESG and sustainable investing cannot be treated as mere add-ons; they must be integrated into strategic asset allocation. Strategic asset allocation involves determining the optimal mix of different asset classes within an investment portfolio. Trustees must continuously examine their investment strategies and portfolios to ensure long term sustainability.

A sound investment policy begins with a thorough examination of the current strategic asset allocation, taking account of material ESG factors affecting all assets, not just new investments. The proportion of assets invested in sustainable investments that have an impact on the real economy should be optimised without compromising financial returns.

Investing in low-carbon transitioning companies

When selecting investments, retirement funds should prioritise companies with workable plans to reduce carbon emissions. They can also incorporate this focus into the construction of passive portfolios. Furthermore, active ownership with robust engagement and proxy voting practices should accompany these investments.

While ESG funds and green bonds are desirable, investing in low-carbon transitioning companies often has a more significant real world impact on carbon emission reduction.

Considering ESG in offshore investments

When diversifying through offshore investments, retirement funds must not overlook ESG and sustainability considerations. Trustees should apply their same domestic standards to foreign investments by engaging asset managers who prioritise global ESG factors. Conducting sound due diligence in this space is crucial.

Capitalising on renewable energy opportunities

The electricity and solar markets present significant opportunities for strong returns for retirement funds. As such, trustees should explore all opportunities in renewable infrastructure funds that offer attractive returns and contribute to sustainable energy solutions. Many renewable infrastructure funds have consistently outperformed benchmarks. In addition, keep an eye open for opportunities arising from the forthcoming JET-IP Implementation Plan, which should assist in identifying promising projects.

Harnessing the power of alternative investments

Alternative investments, such as private equity, provide opportunities for retirement funds to allocate more to the real economy, particularly in infrastructure. Private equity investments offer unique characteristics that can potentially yield higher returns and enable active involvement. They also facilitate funding for innovative and impactful projects that may not be easily accessible in public markets. South African funds should expand the potential of this asset class to drive impactful investments.

Ensuring asset managers embrace a new mindset

Successfully navigating the new landscape of sustainable finance requires a shift in mindset and the development of new skills. Investment professionals must embrace the changing environment and upskill themselves accordingly. Private equity investments, for example, require new skills and capabilities such as project management, due diligence and engineering, in addition to traditional accounting expertise. Addressing the shortage of viable investment opportunities requires collaborative effort, knowledge sharing and inventive solutions, which can build a robust pipeline of investible projects.

Purposeful investing

Retirement funds can make a significant impact by selecting and fostering boutique investments focused on sustainability. This includes actively seeking exposure to the green economy, aligning investments with the Sustainable Development Goals, or investing in projects that explicitly create jobs. Exploring innovative finance options such as blended finance, which combines public and private sector resources, can help fund projects targeting job creation or providing guarantee mechanisms to cover credit losses. Again, in due course, funds can refer to the JET-IP Itinerary as a guide to identifying development projects.

Learning from ESG leaders

Some funds have achieved high and consistent returns with positive social impact through considered use of alternative asset classes. Learning from these ESG leaders can provide valuable insights on how retirement funds can allocate a portion of their investments to directly make a positive impact.

Conclusion

South Africa is the retirement destination for the majority of fund members so is it is important to evaluate how retirement investments can make a positive impact on the country. Retirement funds have a responsibility to go beyond traditional investments and focus on areas that can lead to increased impact and a more sustainable future for retirees in the broader society.