INTEGRATION OF ESG FACTORS AND RISKS IN INVESTMENT

Pablo Antolin
Principal economist and Head OECD Private Pensions Unit,
Deputy Head OECD Consumer Finance, Insurance, and Pensions and Division

BETTER POLICIES FOR BETTER LIVES

OECD main messages

- Sustainable investment opportunities and ESG investment opportunities are part of pension fund investment policy and risk management
- OECD work establishes that fiduciary duty does not prohibit ESG integration nor prevents it
- Regulation permits ESG investing, beyond the fiduciary of best interest of members (best real risk adjusted returns net of costs)
- Investors interpretation: prudent man, efficient market (everything is in the price), and lack of clarity on the rules by the regulator may discourage ESG integration

OECD main messages

- There are important practical barriers to move from incorporating ESG factors and risks in their investment policy and implement them in their investment strategies
  - Lack of standardised and homogenised data
  - Lack of standardised and appropriate disclosure
  - Lack of appropriate models, indicators, metrics, and approaches to assess ESG investment opportunities
  - Availability of ESG investment opportunities that provide good risk adjusted net returns
  - Greenwashing
  - ESG no matter what (investment risk management)

OECD main messages

- ESG integration does not necessarily lead to unintended consequences in terms of portfolio risk
  - It does not imply sacrificing returns in order to support non-financial objectives
  - It may lead to enhance portfolio performance
- IOPS Supervisory Guidelines on the Integration of ESG Factors in the Investment and Risk Management of Pension Funds

Integrating ESG: mandate - practice

- Investment opportunities in environmentally friendly projects (the E); on socially responsible projects (the S); and in companies with good governance (the G) is part of pension fund investment policy and risk management, but needs to be incorporated in their investment strategies and portfolio
- It is also good policy: consider all opportunities and risks, diversification
- ESG investment opportunities are like any other other investment opportunities (they involve certain risks). They have however, a different set of factors and risks than traditional investment
  - Long-term sustainability of economy activity (macro impact, GDP growth)
  - Physical risk: property damage (weakened balanced sheet)
  - Transition risk: stranded assets (disruption business models, disorderly repricing

Integrating ESG: mandate - practice

- ESG investment opportunities need to be evaluated like any other investment opportunities and choose those ones that add value
- ESG investing can add value (i.e. risk-adjusted real returns net of expenses), but not all add the same value, some will be better than others.
- Pension funds and investment teams: large pension funds can have dedicated teams to assess and evaluate ESG investment opportunities an incorporate them in their investment strategies
- Small and medium sized pension funds need instruments, models and metrics to evaluate the different ESG investment opportunities and thus choose among them, they cannot afford dedicated investment teams
- Careful with greenwashing, index investing.

Integrating ESG: returns enhancing or sacrificing

- ESG investing can add value (i.e. risk-adjusted real returns net of expenses)
- There are many studies that suggest that ESG provide better returns or investors investing in ESG get better returns than others.
- However, this evidence cannot be generalised because of
  - Short time frames difficult to generalise (no long data series)
  - Investing in something new that have more demand than supply create spurious gains that over time, as markets tend to equilibrium, may disappear.
- But no-one can either dismiss the evidence. It can be the result of long-term or short-term
- This points again to the need of models, instruments and metrics to assess the different ESG investment opportunities and have proper risk management processes.

Way forward

- Clarify that ESG integration is consistent with institutional investors' obligations
- Support initiatives to overcome practical and behavioural barriers
- Higher quality of data and standardised date reporting
- More robust modelling techniques: examine and provide tools to enable institutional investors to implement investment strategies that incorporate ESG factors and risk

- Focus on: models, metric and techniques to make appropriate investment decisions and risk management that take into account ESG investment opportunities

Conclusions

- We need to discuss how to integrate ESG in the investment policies of pension funds, how ESG risk and factors become part of investment portfolios
- We need instruments for pension funds to integrate them and for regulator and supervisors to supervise that it is done in the best interest of members
- Happy that after me we have today two different angles on how ESG risks and factors can be integrated by pension funds and how pension supervisors and policy makers can promote that pension funds integrate ESG factors in their investment strategies.
- Dr Jathip to inform us the way a large pension fund, the GPF of Thailand is dealing with incorporating ESG risk and factors in the investment strategies of their institution
- Mr. Khawar will explain to us how a regulator and supervisor makes sure that ESG factors and risk can be taken into account without affecting the main mandate of investing in the best interest of members

THANK YOU VERY MUCH!

OECD work on pensions

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