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How public pension and sovereign wealth funds mainstream sustainability

Practices of the frontrunners and a proposed integration framework

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Executive summary

Economic, social and corporate governance (ESG) factors constitute material risks as well as business opportunities for institutional investors, such as public pension and sovereign wealth funds (SWFs). As "universal owners" with large shareholdings in companies across a huge range of sectors and markets, these funds are in a unique position to drive ESG inclusion along the investment chain through active and responsible ownership.

Among the world's 50 largest public pension funds and 30 largest SWFs, the report finds that only 16 public pension funds and 4 SWFs published a sustainable or responsible investment report in 2019. This shows that these institutional investors still have a long way to go on ESG integration 15 years after the creation of the Principles for Responsible Investment (PRI).

By reviewing the annual sustainable investment reports of these 20 frontrunner funds, this study identifies a rich pool of good practices for sustainability integration in five strategic areas: governance, corporate sustainable investment policies, sustainability integration strategies, ESG integration along the investment chain, and evaluation and reporting.

Key findings of the report include:

- Strong leadership and a team dedicated to ESG integration are important drivers of change and good practice.
- Well-developed corporate sustainable investment policies, aligned with international ESG benchmarks and guidelines, are instrumental for ESG integration. At least 17 international benchmarks are used by the 20 frontrunners funds, with some more widely used than others.
- Sustainable investment strategies have evolved from relatively simple approaches (such as exclusion or negative screening) to more sophisticated ones. Impact investment (including SDG-themed investment) has been among the most widely used strategies reported by the 20 funds, showing an ongoing transition from responsible investment to sustainability-dedicated investment.
- Active ownership through systematic engagement and voting is required for affecting change on ESG and SDG-related issues along the investment chain.
- While the lack of consensus on a sustainability reporting framework and quantitative and qualitative indicators remains a severe challenge, frontrunner funds are making progress in utilizing international standards to enhance the quality of sustainability reporting, in particular on environmental issues.

Based on the best practices of the 20 frontrunning funds, *this study proposes a framework that can be used by their peers and asset managers to act on sustainability in-line with their operational model and strategic priorities.*

The ESG integration framework covers seven action areas:

I. Formulate a new generation of company values and mission aligned with sustainability
II. Put robust governance, policies and processes in place that are aligned with sustainability
III. Take a holistic approach to ESG integration
IV. Integrate sustainability along the investment value chain
V. Measure sustainability risks, impact, and performance
VI. Publish high-quality sustainable investment reports annually
VII. Partner with peers and international initiatives

About the UNCTAD Investment and Enterprise Division and the SDG Investors Partnership

The UNCTAD Investment and Enterprise Division is the focal point in the United Nations System for investment and enterprise development. As a global centre of excellence, the Division conducts leading-edge research and policy analysis, provides technical assistance to 160 member States and regional groupings, and builds international consensus among the 196 member States of the organization. Its mission is to promote investment and enterprise for sustainable development and prosperity for all.

The SDG Investors Partnership, initiated by the UNCTAD Investment and Enterprise Division, aims to foster partnerships among institutional investors, governments, and international organizations to facilitate institutional investment in key SDG sectors, in particular in developing countries. The Initiative, in partnership with all stakeholders, seeks to create an enabling environment for SDG-oriented investment by institutional investors through evidence-based research, dissemination of best practices and international standards, consensus building and policy advocacy on strategic issues that are critical for facilitating institutional investment in sustainable development.

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Abbreviations

ABP	Stichting Pensioenfonds ABP
Alecta	Tjänstepension hos Alecta
ATP	Arbejdsmarkedets Tillægspension
AUM	Assets under management
Bpf Bouw	Bedrijfstakpensioenfonds voor de bouwnijverheid
CalSTRS	California State Teachers' Retirement System
CDP	Carbon Disclosure Project
CPP	Canada Pension Plan
ESG	Environmental, Social and Governance
EU	European Union
FTSE	Financial Times Stock Exchange
GCI	Guidance on Core Indicators for Entity Reporting on Contribution towards Implementation of the SDGs
GHP	Greenhouse Gaz Protocol
GPFG	Government Pension Fund of Norway
GPIF	Government Pension Investment Fund
GRESB	Global Real Estate Sustainability Benchmark
GRI	Global Reporting Initiative
ICGN	International Corporate Governance Network
IORP II	Occupational Retirement Provision
ISAR	Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting
KPI	Key performance Indicator
LEED	Leadership in Energy and Environmental Design
MiFID II	Financial Instrument Market Directive II
MSCI	Morgan Stanley Capital International
NYS Common Retirement Fund	New York State Common Retirement Fund
NZSF	New Zealand Superannuation Fund
OECD	Organization for Economic Cooperation and Development
OTTP	Ontario Teachers' Pension Plan
PAL	Pension Fund Association for Local Government Officials
PFZW	Stichting Pensioenfonds Zorg en Welzijn
PPF	Pension Protection Fund
PPP	Public Private Partnerships

PRI	Principles for Responsible Investment
PSP	Public Sector Pension Investments
SASB	Sustainability Accounting Standards Board
SDGs	Sustainable Development Goals
SRD II	European Union Shareholder Rights Directive II
SWF	Sovereign Wealth Fund
TCFD	Task Force on Climate-related Financial Disclosures
Temasek	Temasek Holdings
UK	United Kingdom
UNGC	United Nations Global Compact
US	United States
USS	Universities Superannuation
VBDO	The Dutch Association of Investors for Sustainable Development
WSIB	Washington State Investment Board

1. Introduction

To achieve the United Nations' Sustainable Development Goals (SDGs), UNCTAD estimates that developing countries alone face an annual financing gap of $2.5 trillion (UNCTAD, 2014). Bridging this gap requires the mobilization of capital to relevant sectors and markets, such as health, energy and agriculture. However, it also demands the alignment of investments with more responsible and sustainable criteria that impact the environmental, social and governance (ESG) practices of economic actors.

Given their long-term obligations, public pension funds and sovereign wealth funds (SWFs) are in a better position to assess long-term risks to their portfolios, and the inter-generational nature of their business model tends to make them more responsive to ESG and SDG-related issues. Consequently, there has been a realization on the part of these large institutional investors that ESG factors constitute material risks for the sustainability of their investments. At the same time, as "universal owners" with large shareholdings in companies across a huge range of sectors and markets, these funds are in a uniquely powerful position to drive ESG inclusion along their investment chains through active and responsible ownership.[1]

There is a clear business case for ESG integration, in addition to a moral one. The COVID-19 pandemic again demonstrates that neglecting environmental risks can expose society and the economy to natural disasters, as well as pandemics, that can suddenly hurt the value of the assets held by pension funds, destabilize their actuarial positions and jeopardize their obligations to beneficiaries.

This report identifies 16 public pension funds and 4 SWFs that published a sustainable or responsible investment report in 2019 among the world's biggest public pension and sovereign wealth funds (50 pension and 30 SWFs), and examines how the 20 funds are mainstreaming sustainability into their investment decisions along their investment chain. The report aims to identify good practices as well as lessons that can be learned by their peers on how to integrate ESG and sustainability (including the SDGs) into their business model and investment decisions.[2] These ESG or sustainability-aligned investments are referred to collectively as sustainable investment in the report. These include: responsible investment, that is investments that behave responsibly in their investing strategies and operations, and sustainability-dedicated investments, that is investments targeting sustainability or SDG-themed areas or sectors such as clean energy, clean technology and food security, as defined by UNCTAD (UNCTAD, 2020a).

The findings of the report reveal that the 20 funds have been active in the promotion and