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I like the idea of ESG
but what is it going to cost me?

A look into whether Environmental, Social and Governance (ESG) investing comes at the cost of financial performance, and what this means for the evolving pension fund member.

The ESG generation

It is predicted that, by 2020, millennials will comprise 50% of the world's workforce[1], intimating that younger workers will become a more influential group in investment and employee pension schemes.

There is also mounting evidence that the younger generation expect their investment managers to practise sustainable investing, with the DCIF[2] revealing that members aged 22-34 are almost 50% more interested in investing responsibly than all other age groups. Coupled with this, journalists previously identified investment solutions incorporating ESG criteria as the top trending theme in 2018. They anticipate that this trend will continue in 2019, but with the expectation that managers will have to demonstrate their ability to meet ESG criteria[3] more clearly.

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Quantifying ESG performance

The question we get asked regularly at Dean Wetton Advisory is whether ESG investment comes at the cost of financial performance and, if it does, would this to some extent mute the ESG chorus of younger people? In order to provide our clients with the best advice, we recently conducted research into the past financial performance of ESG investing through a combination of academic research and analysis of ESG index performance data. We combined these findings with member behavioural surveys sourced from the DCIF, to give our institutional clients a better perspective on the ESG debate.

What we found is that there is overwhelming evidence that younger pension scheme members hold different expectations for ESG-related performance and risk compared with their fellow older members. We also found information that offers clues as to which of the components of E, S and G are more important to investors, which asset classes perform better under ESG criteria and, finally, what the main drivers are for asset owners to monitor external managers' ESG practices.

Table 1: The ESG components (source PRI)

ENVIRONMENTAL	SOCIAL	GOVERNANCE
• Climate change • Greenhouse gas emissions • Resource depletion, including water • Deforestation	• Working conditions including slavery and child labour • Local communities, including indigenous ones • Conflict • Health and safety • Employee relations and diversity	• Executive pay • Bribery and corruption • Political lobbying and donations • Board diversity and structure • Tax strategy

Clarity of advice on ESG

The ESG study has helped us to provide clearer advice to our clients on the trade-offs to be made around ESG. Specifically, this includes advice to pension fund Trustees when reviewing their fund's investment principles for ESG, as well as providing valuable input into the optimisation of self-select options. Finally, we have been able to enhance the advice offered on the allocation of ESG investments for pension fund default portfolios.

Although our advice is tailored to specific clients, we feel that the research and approach we have undertaken in ESG lays a solid foundation for further work in this constantly developing area.

[1] PwC: Workforce of the future - The competing forces shaping 2030 (2018)
[2] Defined Contribution Investment Forum - Navigating ESG: a practical guide (2017)
[3] JPES - The Asset Management Report 2019 & 2018

Should you wish to learn more about ESG or any of our other consulting services, please feel free to contact trent.mclelland@deanwettonadvisory.com

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