ESG investing under fiduciary management

How the £200bn UK pensions fiduciary management market is keeping pace with evolving ESG practices.

June 2023

EY Parthenon

Building a better working world

Introduction

How environmental, social and governance (ESG) factors are considered in pension scheme decision-making and operations continues to evolve at pace. We are seeing more and more pension schemes, and their service providers, embracing the important role pension scheme capital has in influencing the projects and companies they finance to accelerate change in ESG areas, to help protect the retirement outcomes of their members.

Continuously evolving ESG expectations

New developments in ESG have been driven by regulation, the investment industry, activists, and pension scheme pioneers. Over the past 12 months alone we have seen a number of developments. These have included the UK Department of Work and Pensions launching a task force on social factors, the first wave of climate reporting for large schemes (and the Pension Regulator's feedback on this) and the FRC's UK Stewardship Code raising the bar in terms of what effective and responsible stewardship of capital is.

Over this time we have also seen continued growth in the number of pension schemes using fiduciary management, including several large in-house pension investment teams joining fiduciary managers. We expect to see continued growth in this market, especially in light of the recent gilts crisis which has encouraged many trustees and corporate sponsors to revisit their investment governance and operations.

EY teams approach

This is EY's third industry-wide survey looking at how ESG is being incorporated by the fiduciary management market. The survey covers 15 fiduciary managers who collectively manage over £200 billion of assets for UK pension schemes and focusses on their activities over the last 12 months. The fiduciary managers cover a range of client sizes and both those that mostly use external asset managers or offer in-house funds.

In this survey we have assessed the participating fiduciary managers across 6 key areas: governance, risk management, investment integration, stewardship, climate change and reporting. In our capacity as an independent oversight provider, we are uniquely placed to build a picture of the entire industry and assess the different stages of ESG maturity exhibited by different fiduciary managers.

Whilst this survey focused on the fiduciary management industry, the key conclusions also apply to the adviser market given the overlap between the number of providers who provide both advisory and fiduciary management services and take a consistent approach across both.

Given the pace of change in both ESG and fiduciary management it is often difficult to navigate these areas and be confident your provider is adopting current best practices. This is a key area we look into when providing our fiduciary management selection and oversight services. We hope this survey provides insights to help you navigate the market and ensure your member outcomes are protected.

We would like to thank all respondents who participated in the 2023 annual ESG survey.

Scope

6
key areas

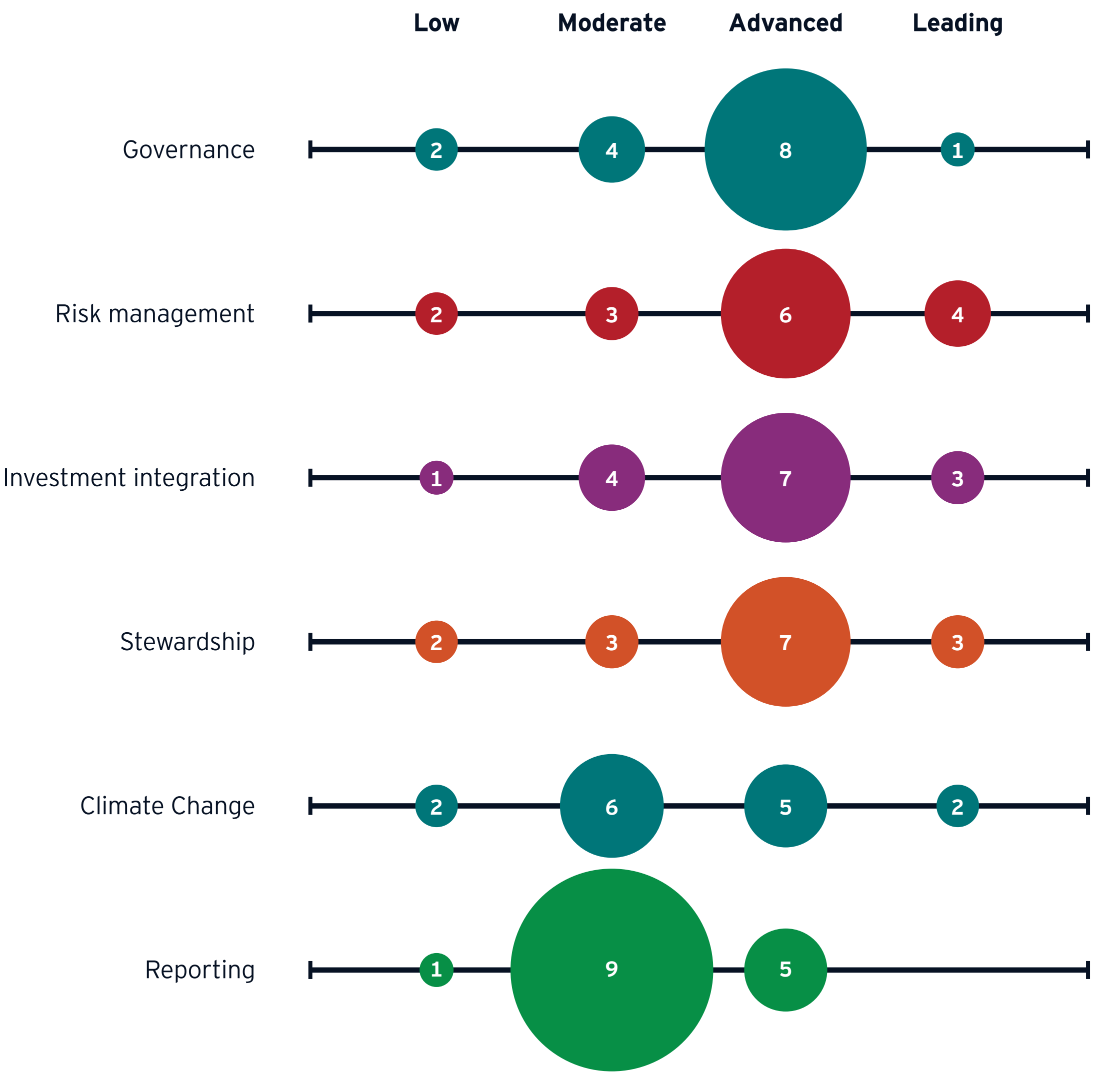
15
fiduciary managers

£200bn
of assets in the UK

Survey highlights

From the survey results, and EY teams' continued research, we have assessed the maturity of each participating UK fiduciary manager across six key ESG areas. In comparison to our previous survey, we have seen that the overall approach to ESG continues to improve. However, simultaneously the bar of what is seen as leading practice has also increased. In particular, stewardship and climate change are two areas where we have seen a marked improvement, with climate change now being a standalone area assessed in the survey.

As can be seen from the chart, there is a wide range of capabilities across the market with different approaches being taken. Although the general standard of ESG integration has improved, some fiduciary managers are starting to materially lag their peers. Climate change was the area with the largest spread in maturity amongst fiduciary managers, and reporting is an area that still requires significant improvement across the board.



The chart shows how the fiduciary managers that we surveyed score against the six pillars

Survey highlights

What questions should scheme stakeholders be asking?

Governance

We have seen an increase in ESG specialists and staff training at fiduciary managers.

Some fiduciary managers are putting in place specific "E", "S" and "G" targets and policies, including on climate and diversity and inclusion.

Do the trustees have up-to-date ESG policies and targets?

Does your fiduciary manager have a training program in place, aligned to your needs?

Risk management

Fiduciary managers usually rely on at least one third-party ESG data provider. But data overload and inconsistency bring its own challenges.

Is your fiduciary manager's data provider strategy in line with Task Force on Climate-Related Disclosures (TCFD) requirements?

Investment integration

Fiduciary managers increasingly set minimum ESG requirements for underlying managers.

Do you have clarity on the standards being applied on behalf of your scheme?

Is your fiduciary manager integrating those minimum standards on a portfolio-wide basis?

Stewardship

Over 85% of UK fiduciary managers are signatories to the UK Stewardship Code. Leading practice is to set strategic engagement themes to discuss with asset managers.

Have you set engagement themes for your scheme?

What is your fiduciary manager's approach to engaging with their underlying asset managers?

Climate change

Close to ninety percent of fiduciary managers provided TCFD reporting for at least one pension scheme in the last 12 months. A range of climate metrics and scenarios are being used, depending on available data, and the reporting narrative is not always clear.

Does your fiduciary manager's TCFD reporting meet regulatory requirements?

Reporting

Over 90% of fiduciary managers provide some form of ESG reporting, but fiduciary managers are struggling to keep up with standards recommended by the UK Stewardship Code.

Leaders are expected to provide regular updates on engagement activities and provide reporting on more challenging asset classes such as derivatives, sovereign bonds and LDI.

How can you improve your scheme's reporting?

Governance

How ESG is embedded into the decision-making processes of a fiduciary manager and how it permeates through their business, culture and staff is critical to good governance. Having robust ESG governance in place increases the likelihood of achieving any decarbonisation, or other ESG targets, the fiduciary manager may have.

Key themes over the year

There remains a range of ESG governance structures across the industry. Since EY's last survey, fiduciary managers have increased the number of resources dedicated to ESG, particularly in climate, as well as increasing the amount of training provided to staff and clients. In the past, ESG governance was often limited to informal working groups, however more formal structures are now typically in place, such as committees, policies and clearly articulated targets.

Policies and targets

All fiduciary managers have some form of responsible investment policy in place, however, some have gone further and put in place specific **"E", "S" and "G" targets**. The more progressive fiduciary managers have developed additional policies, with popular areas being climate, biodiversity and diversity and inclusion.

Resourcing

A small number of fiduciary managers explicitly link quantitative ESG Key Performance Indicators to the remuneration of senior staff. Leading practice is setting ESG objectives for staff at all levels who have ESG responsibilities.

Leading fiduciary managers are making use of **climate specialists** as part of their governance team and are building proprietary tools.

EY TEAMS INSIGHTS

ESG training for staff

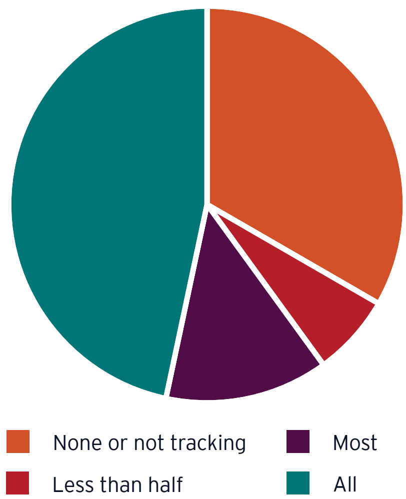
We have seen a significant increase in ESG training for staff. Effective training helps promote sustainability and supports it being integrated throughout a firm. In the leading fiduciary managers, we have observed:

- **Regular training** available to all staff and not just the front office investment team, with sessions tailored to different levels of knowledge. This is often compulsory, particularly for new joiners.
- As well as **internal** training sessions on specific topics, we have also seen a number of fiduciary managers promoting **external courses and qualifications** to staff. While such courses can be beneficial, we note the challenge that course content can often be quite broad, may not be particularly relevant to an individual's role as well as often being out of date given the fast-moving nature of this area.

ESG training for clients

It is now more common for fiduciary managers to proactively provide training to clients on ESG and climate; this is in part due to regulatory requirements (e.g. TCFD). Around half of the fiduciary managers are now providing ESG training to all clients, but around a third still provide no training to clients or don't track what training they provide. Climate training remains less common, particularly for fiduciary managers appointed by schemes with smaller asset bases.

What proportion of your fiduciary management clients receive ESG training?



Bespoke client ESG solutions

Although almost all fiduciary managers confirmed that they can tailor portfolios to meet client-specific ESG preferences, most of the examples provided were portfolio exclusions of certain sectors. Leading fiduciary managers are able to design and implement more bespoke ESG solutions which have become increasingly popular, for example in Buy and Maintain credit mandates.

Risk management

ESG risk management covers the approach to use data and other modelling techniques in order to identify, assess, manage, and mitigate ESG (including climate) risks. This should ideally be embedded into a scheme's wider risk management and framework and be backed up with appropriate tools to monitor risks over time.

Key themes over the year

We have seen a range of well-developed risk management frameworks to identify and manage ESG risks, although there are still some outliers that either have no framework in place or one that is immature compared to peers. Leaders are actively engaging in order to proactively mitigate risks by changing behaviours.

Compared to previous years, in part driven by regulatory requirements around carbon reporting, we have seen an increase in the use of ESG data and climate modelling.

Although still the minority, we are seeing leading fiduciary managers working actively with external asset managers to develop solutions and/or funds that are suitable to meet their own (and on behalf of their clients') ESG and climate ambitions.

ESG assessments of external managers during due diligence and ongoing monitoring.

Analysing ESG data from managers and third parties in order to evaluate the impact of investment decisions on the sustainability characteristics of portfolios.

Screening portfolios for ESG risks and excluding activities that are deemed to have long-term sustainability risks (e.g., fossil fuels, controversial weapons, and tobacco).

Engaging with issuers and external managers. In particular, a few have actively worked with their external managers (or with issuers in instances where the fiduciary manager also directly manages money), to increase exposure towards ESG opportunities and put in place targets to transition portfolios.

Tools and targets in risk management

The majority of fiduciary managers make use of **ESG risk identification tools or software**, however, we observe a broad range in their scope and complexity. This is an area that a lot of resources have been dedicated to in order to develop and advance capabilities.

Leading fiduciary managers are developing proprietary tools and targets to map out their paths to net-zero (for more details see the climate change section).

Climate and sustainability-related risks are recognised in the corporate risk register for over 75% of fiduciary managers. We remain concerned where fiduciary managers are not recognising climate risk in their corporate risk register. It has become commonplace to distinguish these climate risks into physical and transition risks. Leading fiduciary managers are using additional non-climate-related ESG metrics and setting targets around these at the portfolio level. Popular areas include deforestation, gender diversity and human rights.

Leading fiduciary managers will consider ESG in the context of the Integrated Risk Management (IRM) framework, across investment, funding and covenant and incorporate ESG risks into schemes' IRM reporting dashboards.

75%
of fiduciary managers recognise climate and sustainability related risks.

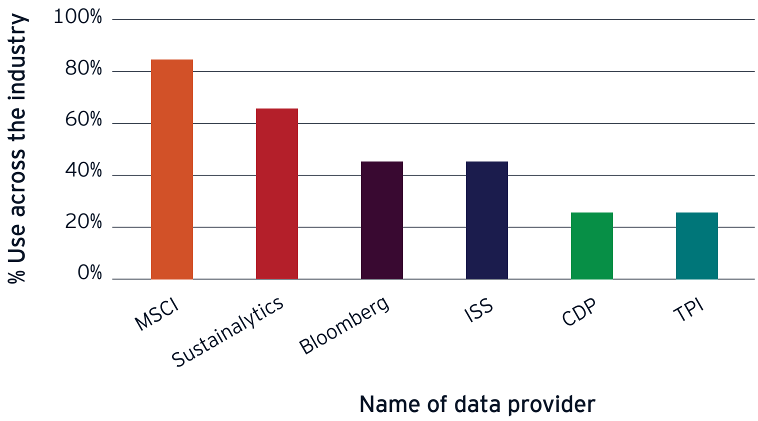
EY TEAMS INSIGHTS

Who are the common third-party data providers?

Nearly all fiduciary managers use one or more third-party data provider in their ESG risk management and modelling.

A popular approach is to overlay external data with proprietary data and methodologies. Accepting third-party data as is, without any oversight or proprietary overlay, is regarded as behind best practice.

The chart below highlights some commonly used data providers, but we note that there is a large spread in which providers fiduciary managers find useful. Other third-party data providers not listed include Reprisk, Ethical Screening and Planetrics.



Note: Does not add up to 100% as some fiduciary managers make use of one or more data providers.

Investment integration

Investment processes cover the investment strategy setting approach, asset allocation, manager selection and ongoing monitoring. Given that responsibility is delegated in a full fiduciary arrangement it is important to assess how the fiduciary manager is integrating ESG throughout the investment process, as well as their ability to reflect any bespoke ESG client preferences.

Key themes over the year

It has been a case of evolution rather than revolution in approaches since EY's last survey. Fiduciary managers continue to use proprietary ESG scoring of external managers, but leading fiduciary managers are starting to develop this framework to integrate ESG factors into wider portfolio construction and asset classes considerations.

Common integration approaches

The most popular method for integrating ESG risk into portfolio construction and management continues to be ESG scoring of external managers.

These proprietary ESG scores are different amongst fiduciary managers and are by definition unique. In this survey, we did not do a deep dive into the different methodologies, but it is important to be aware when selecting, monitoring, and comparing fiduciary managers, that their approach and maturity in this regard can vary quite significantly throughout the industry. We have seen this when we have carried out fiduciary management oversight for EY clients and it is particularly the case as it relates to ESG ratings of different asset classes.

EY TEAMS INSIGHTS

Of the fiduciary managers that participated in EY's survey, who make use of external managers, **54%** set a formal minimum ESG requirement that individual underlying managers must meet in order to be invested in.

Another **40%** of participants stated that there is no formal minimum ESG standard or requirement, it is unlikely that poorly scoring managers will make it into the portfolio.

Only **one** participant stated that they explicitly do not exclude an underlying manager due to not meeting minimum ESG requirements.

It is now also commonplace for ESG risks to be considered when setting capital market assumptions which are used in longer-term investment strategy setting.

Most fiduciary managers are supporting their clients set ESG metrics and targets, including net zero targets for portfolios. Nine out fifteen respondents had helped all of their clients to set ESG metrics and targets, but six have only done so for a smaller number of clients on request.

We see divergence in exclusion approaches. Some fiduciary managers apply simple screens (for example not investing in tobacco), while others can set up bespoke screens on client request. This is also the area where some fiduciary managers will take a proactive exclusion stance where areas such as tar sands, UNGC violators, gambling, tobacco etc. are screened out by default, whilst others will only do this if driven by the client. Similar comments apply to ESG tilts in portfolios, which is increasingly popular in equity allocations.

9/15

respondents had helped 100% of their clients to set metrics and targets.

Asset classes in the spotlight

There remains a large divergence in terms of integration of ESG in different asset classes, but increasingly more attention is being given to less developed areas like LDI and hedge funds.

LDI ("Liability Driven Investments")	Consideration of ESG factors when engaging with the underlying counterparties has been one way that we have seen ESG integrated into this asset class. A leading practice we have seen is fiduciary managers placing cash into environmentally aware funds (which also include screens) as part of the LDI portfolio.
Hedge funds	This is a wide asset class, with a variety of approaches taken; some fiduciary managers are completely excluding ESG integration, whilst others are developing ESG hedge fund solutions (with screens, and specific carbon footprint targets in place) or allocating to external ESG-specific hedge funds. It is common for fiduciary managers to consider ESG during investment due diligence. Leading fiduciary managers engage regularly with external managers as part of their stewardship programmes, which appears to be having the most impact in the hedge fund industry by improving ESG practices from relatively low levels.
"Impact" investments	Impact investments span a range of different asset classes. Around half of the fiduciary managers now have allocations to impact investments or sustainable-labelled investments for some of their clients. Overall allocations remain low (below 20% on average) but are rapidly increasing. These are mostly built around gaining access to longer-term sustainability trends in private debt, private equity, property, and infrastructure, and also include allocation to green bonds in LDI portfolios. Leading fiduciary managers are developing sustainability-focused impact solutions. What counts as a sustainable investment is currently loosely defined, but investment labelling regulations under Sustainability Disclosure Requirements are expected to tighten requirements from 2024.

Stewardship

Stewardship represents the use of influence by investors to maximise the overall long-term value of the assets they invest in and ultimately create value for pension scheme members. Depending on the nature of invested assets, varying levels of influence are possible, and stewardship can include voting and engagement on a range of ESG issues that pose a risk to investments. For best practice in this area, we encourage you to familiarise yourself with the FRC's UK Stewardship Code.

Stewardship, including engagement and voting, form some of the most important tools in which fiduciary managers can bring about actual positive change within the industry.

Key themes over the year

Stewardship is the area of the market that we have observed to be most mature, but we have continued to see evolution in terms of stewardship and engagement approaches. This is perhaps not surprising given that 87% of fiduciary managers that participated in our survey are signatories to the FRC's UK Stewardship Code, which continues to raise the bar on the standard of stewardship expected in order for asset owners and managers to retain signatory status.

In particular, there has been a move for fiduciary managers to set strategic engagement themes for interactions with external managers and to engage with the wider financial system.

Some fiduciary managers are also starting to take pension scheme member views into account.

87%
are UK Stewardship Code Signatories.

What are fiduciary managers expecting of their external managers?
Leading-class practice is to engage with external managers who are lagging on ESG rather than taking an immediate exclusion or screening approach. It has been positive to see an increasing number of fiduciary managers engaging with their lowest-scoring managers to improve their ESG approach (rather than simply excluding them).

Whilst it is rare for fiduciary managers to have a strict requirement that their external managers need to be UK Stewardship Code signatories or equivalent (less than 20% of fiduciary managers have such a requirement) the majority encourage this and show a preference towards Code signatories.

EY TEAMS INSIGHTS

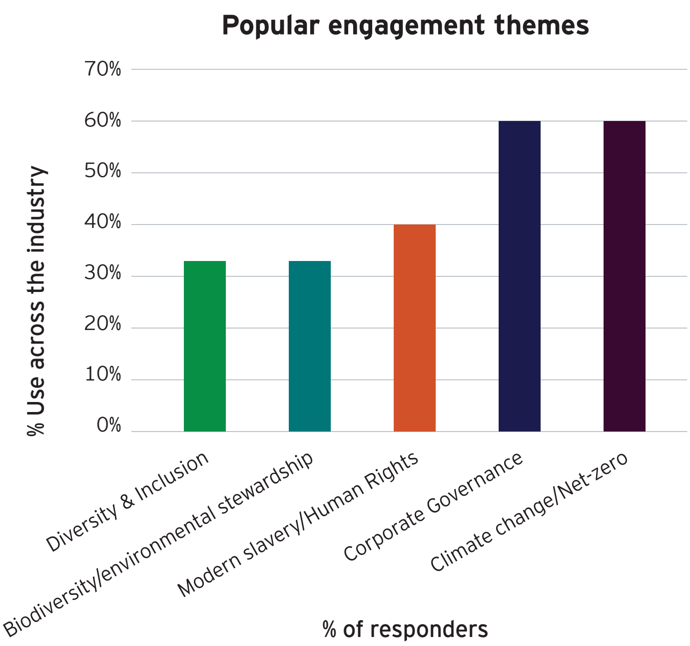
Engagement themes

The principles of the UK Stewardship Code require signatories to monitor the activities of asset managers and hold them to account. To meet this requirement, it is common to set strategic engagement themes to discuss with asset managers and issuers.

1 Although most fiduciary managers will describe themselves as having set strategic engagement themes, some have only recently put them in place. It is yet to be seen how well these have been implemented and reported on in practice.

2 Some fiduciary managers will set themes at the firm level and apply them throughout the organisation's products (not limited to fiduciary management portfolios). Others take the approach to identify key engagement topics within their manager research teams and apply these to certain parts of client portfolios by interacting with external managers on these themes.

3 Engagement themes selected are typically those that are most material to the portfolio and where the fiduciary manager has most influence to bring about change. Best practice is for fiduciary managers to use the engagement priorities to help mitigate ESG risks.

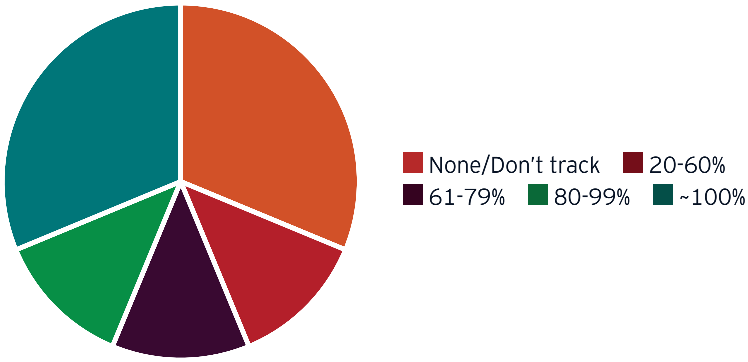


Note: Not all fiduciary managers have engagement themes, and some have one of more, hence the chart does not add to 100%.

EY TEAMS INSIGHTS

Not all fiduciary managers conducted ESG engagements over the year, and in some cases fiduciary managers still do not track this information. Given that signatories to the UK Stewardship Code are encouraged to track this engagement information, we expect this to improve in coming years.

% of engagements throughout the year related to ESG



Voting

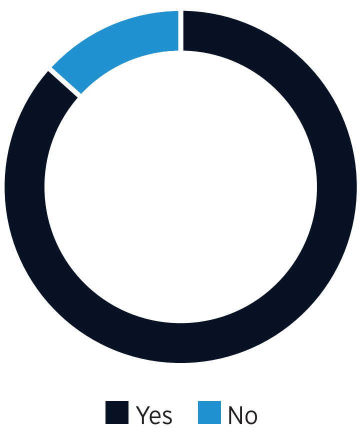
The FRC continues to place increased focus on engagement rather than simply monitoring, emphasising that engagement should be distinct from routine monitoring with specific goals which are measurable. It is therefore pleasing to see that all fiduciary managers (or external managers on their behalf) **exercised their voting rights in at least 96% of votes in the last 12 months**. Abstentions were almost always as a way to implement their voting intention (for example to not support a resolution if the option to vote against was not provided) or due to challenges such as a lack of disclosure regarding the proposal to be voted on.

96%
of votes voted in last 12 months.

Leading fiduciary managers will further analyse the voting behaviour of their underlying fund managers when assigning their ESG scores, as well as using this information in regular engagement with their underlying managers. This added scrutiny and challenge provides increased robustness in ensuring that ESG is thoroughly integrated and overseen.

When it comes to voting, **more than 90% of fiduciary managers make use of a proxy voting service**, either directly, or indirectly via their external managers, with the most popular providers being Institutional Shareholder Services (ISS) and Glass Lewis. Other providers are EOS at Federated Hermes and Sustainalytics. Note that some fiduciary managers employ more than one proxy voting service.

Proxy voting service?



Taking responsibility when delegating voting activities

1 Leading-class practice is for the fiduciary manager to take ultimate responsibility, rather than completely delegating voting behaviour to underlying managers. For example, leading fiduciary managers will do a thorough review of individual company meetings and assess each agenda item, thereby ensuring that the ultimate decision on how to vote rests completely with the fiduciary manager as opposed to the proxy voting service. This oversight function is typically formalised and visible in the governance structure of leading fiduciary managers.

2 We have seen leading-class practice in the industry in that some fiduciary managers will have their own detailed voting policy (including their own bespoke voting rules), and partner with their proxy voting advisor to ensure that these policies are implemented in practice.

3 Leading fiduciary managers will have a clear link between their engagement themes and priorities with their voting policies. For example, if biodiversity and human rights are a key priority for a fiduciary manager, they will include what they expect in this regard in their voting policy and expect their proxy voting provider to vote in line with these expectations. This is a way in which ESG intentions can bring about real-world change in practice.

Engaging with the wider financial system

As encouraged by the UK Stewardship Code, **we have seen the vast majority of fiduciary managers (over 85%) actively engaging with the wider financial system, policymakers, and engagement bodies**. Many fiduciary managers participate in industry consultations, as well as engaging with policymakers through formal networks and associations (such as the IIGCC and The Investment Association).

There is a vast number of collective engagement bodies that UK fiduciary managers are involved in, with some of the more popular bodies including IIGCC, Climate Action 100+, PRI working groups, Global Impact Investing Network and International Corporate Governance Network.

For best practice, it is important that a fiduciary manager can demonstrate that they are an active participant and make meaningful contributions.

EY TEAMS INSIGHTS

Taking pension scheme member views into account

Fiduciary managers generally consider the ESG views of the trustee board and their investment preferences. Whilst still rare, we have seen some fiduciary managers also explore taking the views of pension scheme members into account. Services such as Tumelo have been trialled in order to see how individual member views can be considered in the investment strategy. Typically, this will be enacted in practice via voting. Member views are collated and translated into a belief, which is used to inform voting policies (which are also shared with proxy voting services). It remains to be seen whether this will become a more widespread practice, but it is becoming more widely used in defined contribution pension schemes.

Climate change

Climate change is a fast-evolving and increasingly scrutinised area of fiduciary management, particularly with the introduction of the TCFD regulations. Estimating the potential future impacts of climate change relies on complex scenario modelling and climate metrics, with evolving levels of data available. Best practice is to use the available data and modelling to set clear decarbonisation strategies and consider the impact of climate change across investments, funding, and covenant holistically. It is also important to make sure that the messages are easy for a typical trustee or member to understand, while meeting detailed regulations, which can be a challenging balance to strike.

Key themes over the year

Many fiduciary managers have been helping their clients to meet the first tranche of TCFD reporting and have been building up their climate expertise rapidly. We have seen varying levels of success in the degree to which fiduciary managers have developed modelling capabilities.

There is a large number of climate metrics available to assess investments, but they can differ enormously between providers and in the level of data coverage, which can restrict the metrics chosen for monitoring the climate performance of a pension scheme's portfolio as a whole.

We have seen a widespread adoption of climate targets, both for individual portfolios and for fiduciary management firms as a whole. However, the level of ambition of these targets is variable, as is the degree to which it will be possible to measure progress over time.

Climate modelling

Fiduciary managers with more sophisticated modelling capabilities are generally those whose wider business already has experience of modelling physical risk perils or who have invested in climate modelling specialists. About half of the fiduciary managers offer bespoke scenario analysis.

It has been more challenging for other fiduciary managers to build models in-house, with some exploring support from third parties such as Ortec Finance, Planetrics or MSCI's Carbon Delta service.

Leading-class practice is to be able to model quantitative impacts on a scheme's funding level, rather than just including qualitative statements.

EY TEAMS INSIGHTS

- Most fiduciary managers (87%) have started to produce TCFD reports for clients, with some disclosing on a voluntary basis.
- TCFD regulations require pension schemes to be able to show the impact of climate risk on defined benefit liabilities and covenant as well as on investments. This is an area that fiduciary managers have tackled with varying degrees of success. Some only consider the impact of hedging climate risk on the liabilities and a high-level statement on the impact on covenant, but leading fiduciary managers will liaise with the Scheme Actuary and covenant advisor to incorporate the impact on longevity risk and covenant into scenario analysis.
- The narrative around climate scenario analysis is not always clear, with results often not provided in enough detail or not linked back to investment decision-making. This in line with the findings of TPR's recent TCFD review, which highlighted that disclosures could be difficult to interpret and were not always provided at the correct level.
- There is currently no consensus on the scenarios to use, but leaders use 3-4 scenarios which usually include an orderly transition to a net-zero economy, disorderly transition, and a failed transition.

Climate data and metrics

We had consistent feedback across fiduciary managers that sourcing climate data has been challenging. In particular, data on illiquid investments and the scope 3 component of financed emissions have been difficult to obtain.

As a result of the data challenges, it has therefore become common for fiduciary managers to suggest that clients set climate data coverage as one of the TCFD metrics for clients to monitor and improve.

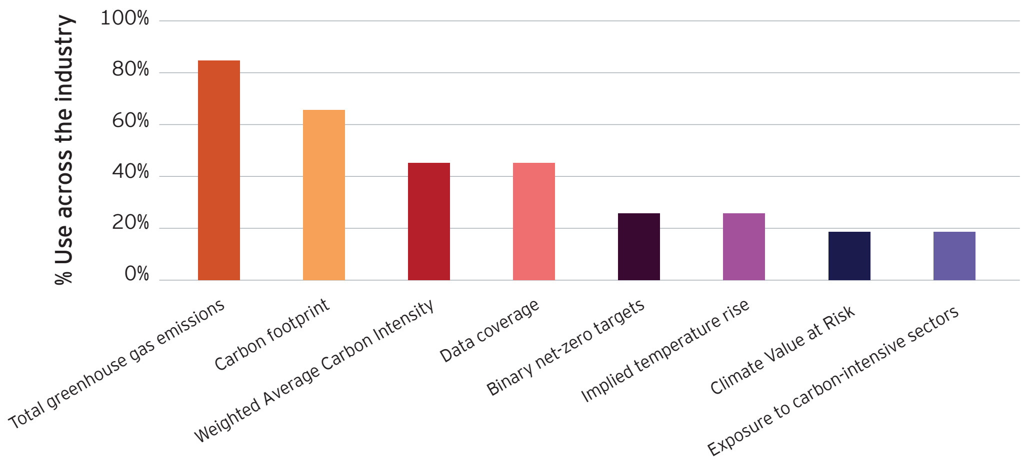
Of those who have started to report under TCFD, where there is a choice of metrics (for example both carbon footprint and carbon intensity are permitted intensity metrics) fiduciary managers have chosen metrics which they believe are easier to understand and have more data available (see the chart on the most commonly used climate metrics). As total greenhouse gas emissions is a compulsory metric, it is unsurprising that all fiduciary managers disclose it.

In October 2022, it also became compulsory to disclose a portfolio alignment metric such as binary net-zero targets or implied temperature rise. Some fiduciary managers already use portfolio alignment metrics, with binary net-zero targets and implied temperature rise being equally popular choices.

87%

of fiduciary managers provided TCFD reporting for clients in the last 12 months.

Most commonly used climate metrics for TCFD reporting



Setting targets

We are increasingly seeing fiduciary managers set climate commitments at the firm and portfolio level, as well as setting targets for clients as part of their TCFD reporting. It is best practice to have a target in place with a clear objective and deadline and interim targets to make sure that progress is made over time.

Climate commitments vary between fiduciary managers but in respect of firms' commitments in relation to their own business, the vast **majority of firms target net zero by 2050, with interim targets commonly set at 2030**. These are currently broader based commitments, rather than science-based targets.

60% of fiduciary managers have put in place targets for invested portfolios (i.e., the assets managed on behalf of clients), but these vary a lot – some use interim targets, some do not. Some apply to the whole portfolio, whereas others apply only to "higher risk" sectors. **The most popular target for invested portfolios is net zero by 2050, with at least a 50% reduction in carbon emissions by 2030**, broadly in line with wider EU and UK ambitions.

Net zero targets at invested level

There is a clear split emerging between fiduciary managers who do not set climate targets on clients' full fiduciary portfolios unless requested by the client and those fiduciary managers who proactively suggest that trustees set targets, which may focus on areas important to the scheme. Both are valid approaches, but we note that there is likely to be more pressure from regulations to set targets in the coming years.

While first attempts at TCFD reporting and target-setting have generally been good, we have seen that **some TCFD reporting targets are more passive**. For example, a target to improve data or carbon emissions "in line with the wider market". Such **passive targets are not in line with the intended purpose of the TCFD regulations, which are looking to encourage more proactive action**, and it will be more difficult to track the success of the target over time, which is one of the requirements of TCFD regulations.

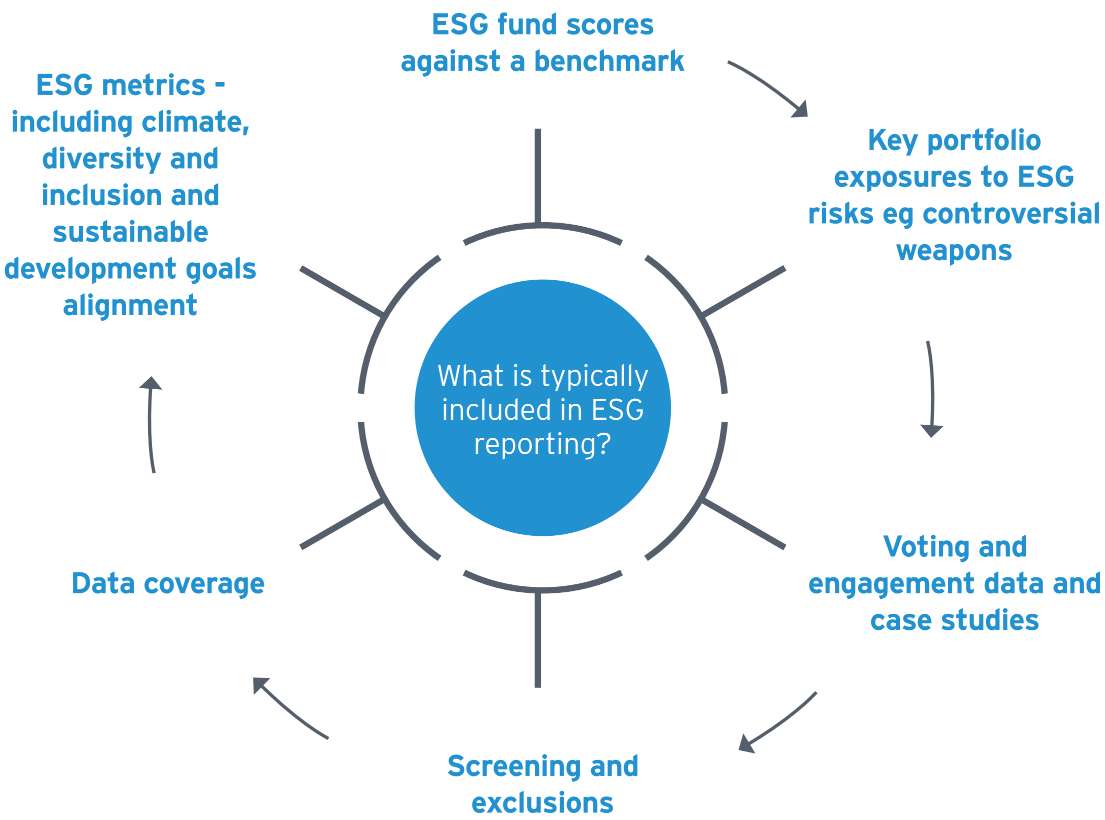
Reporting

Key themes over the year

Reporting remains the least developed area, although there have been some improvements since the last survey, particularly for climate reporting following the introduction of TCFD regulations.

Almost all of the fiduciary managers that we surveyed produced some form of ESG reporting. This is most often in the form of short quarterly updates and a longer annual standalone report, but there remains no standard approach for reporting across the market, particularly in the approach to illiquid assets. It is therefore important to obtain an independent review from time to time to understand how the reporting for your scheme reporting stacks up against others in the industry.

Around half of the fiduciary managers that we surveyed are developing dashboards that are available to clients for additional real-time monitoring of ESG metrics, but it was common to report that data availability made this challenging.



EY TEAMS INSIGHTS

Reporting on stewardship and engagement activities
Signatories of the UK Stewardship Code will be aware of the FRC's increased emphasis on the reporting of activities and outcomes of stewardship and engagement activities. However, **whilst most fiduciary managers have raised the bar in terms of the quality of their engagement activity** examples in annual stewardship reporting, **it was surprising to see that fiduciary managers are rarely providing stewardship activity reporting more frequently**.

In line with the FRC's review findings, best practice reporting is to provide background on engagement activities and progress (or delays) towards outcomes during the reporting period, particularly for those engagements or collaborative initiatives spanning multiple periods.

It is also **crucial to provide commentary to put the data and metrics in reporting into context**. This helps clients to understand what the information means for the portfolio and ensures that they can provide oversight of the fiduciary manager's ESG activities.

ESG reporting in different asset classes
The majority of fiduciary managers produce some form of reporting on their more liquid assets (e.g., equities and fixed income), but leading fiduciary managers also provide detail on illiquid assets.

Private assets saw the largest divergence in terms of what ESG information is provided to clients — with many fiduciary managers excluding these assets altogether, whilst others provided information such as ESG scores, and engagement examples.

For property allocations, it is popular to use Global Real Estate Sustainability Benchmark (GRESB) scores.

An increasing number of fiduciary managers provide information on derivatives, sovereign bonds and LDI, but others exclude these entirely. LDI reporting is typically in the form of providing information on counterparty ESG risk, and breakdown by Government Bond Climate Change Performance Index (CCPI) score and rank, and United Nations Sustainable Development Goals (SDGs) score and rank.

In terms of reporting on liquid assets, the typical approach is to provide proprietary ESG scores, but some use multiple ESG metrics.

EY TEAMS INSIGHTS

How are fiduciary managers responding to data challenges?
Fiduciary managers agreed that data availability is still lacking in many areas, particularly for more illiquid assets, and methodologies for metrics are not always standardised. As methodologies amongst data vendors are proprietary, and therefore differ, it makes presenting the data in a consistent way difficult.

Whilst over 90% of fiduciary managers say they engage with the wider industry to improve availability of ESG data, when questioned on their approach it was clear that some fiduciary managers are doing considerably more than others. Some fiduciary managers are waiting on further guidance from regulators before making changes, whilst others will actively engage in order to improve data availability and other associated challenges.

In closing

We firmly believe that engaging in purposeful conversations about ESG can help drive industry developments. EY teams openly collaborate with fiduciary managers and other large asset owners on ESG, and as part of this survey have offered feedback sessions to the survey participants to discuss their areas of relative strengths and weaknesses observed through this survey.

The world is asking for change. It is clear that the ESG best practices, solutions and regulations continue to move at pace. We firmly expect topics such as biodiversity and integration of members' views to be areas of increasing importance going forward, with some schemes starting to look at these areas already. Furthermore, we expect to start seeing emerging consensus on how to assess ESG performance for different asset classes which should lead to improvements in data availability and reporting.

With higher expectations from the FRC and increasing ESG regulation, it is more important than ever to consider an independent review of what your scheme is doing.

With a 20+ year legacy in sustainability and ESG services, EY combines deep technical skills across a breadth of business issues to help business create value for sustainability as well as help sustainability create value for business. We are supporting trustees and corporates in navigating ESG and climate change and helping EY clients meet their ESG objectives with confidence by ensuring their approach is aligned with emerging and best practices. We have supported numerous schemes to set ESG and climate strategies and helped trustees and corporates assess how their ESG processes and reporting compare to the wider industry. We can also help schemes with meeting TCFD disclosure requirements, assisting with drafting or reviewing your existing reporting against the regulations and best practices.

Please get in touch for more information on how we can help you.

Assessment methodology

EY teams ESG market practice assessment is based on the maturity matrix methodology, which sets out four levels of maturity: "Low", "Moderate", "Advanced" and "Leading". In defining the characteristics of the four levels of maturity, EY teams have considered the features of the different ESG approaches adopted by not only fiduciary managers but also by other asset owners that EY teams have engaged with in relation to ESG. A "Low" maturity level means that the fiduciary manager is yet to fully adapt their processes and solutions to enable clients to comply with minimum ESG requirements. A "Leading" maturity level implies that the fiduciary manager is a market leader and is actively driving ESG developments within the industry. Based on the survey analysis and individual feedback meeting discussions with UK fiduciary managers, EY teams have assessed the ESG capabilities of fiduciary managers and positioned each fiduciary manager within a maturity bracket across the six dimensions below. EY introduced a new section, Climate Change, in the latest survey, to assess in more detail this area that is received increased regulatory scrutiny, particularly with the introduction of TCFD reporting and climate modelling requirements.

As the maturity matrix shows, the fiduciary management market is generally more evolved in areas of governance and stewardship. There are wider ranges of maturity levels observed across investment processes and risk management. Similar to prior years, ESG reporting is the least mature category within EY's survey and is an area we expect to see significant developments in the future. We note that climate reporting has improved in quality. It is essential to recognise that the maturity matrix above captures a snapshot market position as of March 2023. As the industry evolves, EY teams expect the maturity matrix methodology to evolve and the position of different fiduciary managers to change.

Key sustainability questions that we help pension scheme clients and their sponsors to address

Stewardship, reporting and disclosures

Benchmarking

How is our stewardship and governance approach versus market practice?
Are we ahead or behind?

Gap completion

As an FRC Stewardship Code signatory, what gaps do I need to fill?
How do I fill those gaps?

Disclosure compliance

How do I meet ESG climate and TCFD (Task Force on Climate-Related Financial Disclosures) reporting hurdles?
How do I fulfil corporate carbon accounting demands?

Net zero and strategy

Net zero strategy

What is the plan and timeline for my scheme to reach net zero?
How do I "justly" design and execute this transition?

Management actions

What is my joint company-trustee plan for net zero?
How do I best measure, monitor and manage this plan?

Financed emissions

As the primary enterprise-wide source of financed emissions, how do I measure the scheme's contribution to this key metric?

Risk-led transformation

Risk appetite

How do I set controls and risk appetite for ESG considerations?
How do I measure and manage climate risk?

Integrated frameworks

How do I design an integrated ESG and climate risk framework?
How do I implement this in a practical manner?

Modelling and understanding

How do I raise stakeholders' familiarity with climate risk exposure?
How can modelling or stress testing help?

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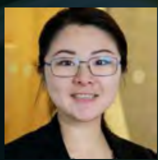

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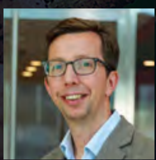

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Enabled by data and technology, diverse EY teams in over 150 countries provide trust through assurance and help clients grow, transform and operate.

Working across assurance, consulting, law, strategy, tax and transactions, EY teams ask better questions to find new answers for the complex issues facing our world today.

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About EY-Parthenon
EY-Parthenon teams work with clients to navigate complexity by helping them to reimagine their eco-systems, reshape their portfolios and reinvent themselves for a better future. With global connectivity and scale, EY-Parthenon teams focus on Strategy Realized — helping CEOs design and deliver strategies to better manage challenges while maximizing opportunities as they look to transform their businesses. From idea to implementation, EY-Parthenon teams help organizations to build a better working world by fostering long-term value. EY-Parthenon is a brand under which a number of EY member firms across the globe provide strategy consulting services. For more information, please visit ey.com/parthenon.

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