DETERMINE ESG OBJECTIVES

Charting the Course: Defining Your ESG Objectives as the Foundation of an Effective Framework

ESG, as non-financial factors and characteristics that can drive long-term value creation, has been a longstanding consideration for many allocators, with a growing number either integrating or expressing interest in integrating ESG into their investment strategies. As the importance of ESG continues to grow, there's an increasing imperative to be specific about ESG approaches. Depending on your stakeholders, there may also be an escalating demand for transparency and tangible results. The key to meeting these demands lies in establishing clear and measurable ESG objectives.

Institutional Allocator ESG frameworks must start with precise ESG objectives. This sets the stage for transparently incorporating ESG into the investment process, whether through selecting managers or direct investments. It facilitates ongoing monitoring and ensures that relevant stakeholders receive comprehensive and insightful reporting on ESG progress.

01

Define with Precision:

Start by clearly defining your ESG Objectives. It's the cornerstone of your framework and sets the direction for your approach.

02

Specificity Matters:

Remember, "ESG" is not a singular objective. Dive deeper into how you want to approach ESG to make your objectives specific and tailored to your organisation's values and priorities.

03

Consider All Perspectives:

When defining your objectives, consider whose viewpoints are essential. Stakeholder engagement ensures inclusivity and helps capture diverse perspectives.

04

Measure for Impact:

Ensure that the outcome of your objective is measurable. Quantifiable metrics enable you to track progress effectively and demonstrate tangible results.

BEYOND BUZZWORDS

Embracing the Diverse Dimensions of ESG Objectives

Don't settle for a vague "ESG" objective – it's a vast landscape with diverse components. Just focusing on the "E" alone encompasses a multitude of critical factors like carbon emissions, water usage, waste management and sustainable sourcing. Attempting to address every aspect of E, S and G in your investment process is overwhelming and impractical.

Institutional allocators must be specific about their objectives. What truly resonates with you or your stakeholders? Where can you enact and sustain genuine change? Trying to tackle too much often leads to achieving little. Instead, hone in on one or two key focus areas and craft your ESG objectives around them. This targeted approach ensures meaningful impact and avoids the trap of ineffectual broad-strokes efforts.

Establishing a feedback loop is crucial in this process, defining your ESG objectives is not a one-time exercise. To keep your ESG framework current, relevant, and deliverable, there should be both proactive and reactive conversations happening between senior management, investment teams and other key stakeholders.

NAVIGATING COMPLEXITY

Balancing Multiple Factors in Crafting Your ESG Objectives

ESG objectives for institutional allocators are shaped by a myriad of influences. Pension funds may weigh the needs of their beneficiaries, sovereign wealth funds might align with government policies and family offices could reflect their own unique philosophies.

Beyond philosophy, whether that of your stakeholders or your own, there are many other factors that should be considered. Many jurisdictions are increasing focus on regulatory reporting requirements on ESG for certain allocators. Aligning your ESG objective with regulatory mandates, or ensuring they can co-exist, promotes coherence amid evolving standards.

An often-underestimated aspect of defining ESG objectives is your investment strategy. Considerations such as asset class, holding periods, position sizes and portfolio concentration can profoundly impact the effectiveness of ESG approaches. Assess whether your desired impact aligns with the characteristics of your investment choices. This proactive consideration ensures that your ESG efforts are not only philosophically aligned but also strategically optimised for tangible results.

One of the most important parts of finalising your ESG objective is how it will be measured; this is the only way to demonstrate tangible results from objectives. This will require analysis of data availability, targets that should be set and the ability of external managers and portfolio companies to provide regular reporting.

DIVERSE PATHS

Exploring the Spectrum of ESG Objectives

As institutional allocators globally have started integrating ESG objectives into their investment strategies there is a wealth of information available in public policies or annual reports to review the directions your peers have taken. Examples of common themes in ESG objectives include:

- Net Zero initiatives with a focus on reducing carbon emissions
- Alignment with the UN Sustainable Development Goals
- Social Impact in areas such as housing, education or healthcare
- Improving Corporate Governance

FORWARD MOMENTUM

Implementing and Reporting on your Defined ESG Objectives

After you have established your ESG objectives, it's time to incorporate it into your entire ESG framework. This means establishing your measurement criteria, crafting your ESG policy and deciding how you will report the outcomes of your ESG efforts.

There are many different ways to incorporate ESG in your investment process, some more resource intensive than others. Allocators can consider options such as tilting the investment portfolio to make sure that ESG does not collide with or inhibit the investment process. Small teams can also make use of outsourced providers in areas such as engagement to allow the right ESG framework to be implemented despite resource constraints. These important steps will be more fully explored in further installments of this series.

AN ILLUSTRATIVE CASE: DUTCH PENSION SCHEME

Taking Beneficiary Engagement to the Next Level

Understanding the needs of your key stakeholders is an important aspect when defining your ESG objectives. A large Dutch Pension Fund, which stated its ESG program in 2018, has taken some additional steps to ensure its beneficiaries are included in the process.

Starting with a survey of beneficiaries in 2021, it has since formed a members council comprised of some of their beneficiaries. The council met for a three-day workshop that included educational sessions from both academic and investment professionals. The members council was then invited to make recommendations to the Board of Trustees in a public letter, and the board publicly responded.

The pension fund intends to repeat this exercise every three years, ensuring a dynamic process of receiving stakeholder feedback to keep their process relevant.

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ORC provides cutting-edge advisory services to institutional allocators and investment managers globally. With assets under advisement of over USD1.5 trillion, we support our clients with comprehending and managing their end-to-end risk landscape, including ESG.

ORC's range of solutions encompasses ESG framework design, ESG due diligence, operational due diligence and custody and fund administrator selection and monitoring. We leverage sophisticated technology to provide efficient and cost-effective solutions to our clients whilst adhering to a robust framework that ensures the quality of our work.

Complexity is a language we speak fluently; we leverage our senior team's over 100 years of practical experience to proactively raise institutional investment standards.

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