Public pension funds: sustainable investment pioneers

Public pension funds across the world are leading on sustainable investment, while many progressive companies lag behind

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Government pension funds are increasingly signing up to investment approaches that prioritise sustainability. Photograph: Anne Gilbert / Alamy/Alamy

Pension funds across the world are increasingly integrating sustainability criteria into their investment strategy and processes. The uptake has been particularly strong in Europe with investment volumes more than doubling over the past five years and with a volume of €6.7tn (£5.8tn), close to 50% of all professionally managed assets in Europe.

Much of the market growth can be attributed to more and more government-sponsored pension plans signing up to a sustainable investment approach, be that the application of exclusion criteria, thematic investments in renewable energy, a best-in-class approach, the integration of environmental, social and governance (ESG) criteria in the portfolio management process and in investment decisions, or, last but not least, an active shareholder policy.

Progressive pension funds

One of the largest and most established sustainable investors is the Norwegian Government Pension Fund with an investment volume of £463bn. The fund was originally established in 1990 by the Norwegian parliament as the Government Petroleum Fund and manages the net proceeds from Norwegian oil and gas production with the purpose of supporting the country's public pension system. Its strategy centres on applying strict environmental and ethical exclusion criteria based on international norms such as the UN Global Compact and OECD guidelines to all its investments. The fund pursues an active shareholder policy and gets involved with the management of companies on governance issues.

The leading French public pension fund, the Fonds de Réserve pour les Retraites with assets of €36.6bn, and CalPERS, the largest US pension plan with assets of close to $250bn (£160bn), both incorporate environmental, social and governance (ESG) issues in their investment processes and follow an active shareholder approach focusing on governance issues. Moreover, CalPERS is a long-time, established leader in sustainable, energy-efficient or "green" real estate.

Latin America's largest pension plan, the Brazilian pension fund PREVI which provides for employees of the state-owned Banco do Brasil, applies exclusion criteria (tobacco and weapons industry) and integrates sustainability and ESG criteria in investments across asset classes.

PGGM, the leading Dutch multi-employer pension plan with assets of over €130bn, applies exclusion criteria focused on human rights and controversial weapons to all its investments and in addition considers sustainability issues in its investment activities. The fund makes thematic investments in sustainable forestry, climate projects, renewable energy infrastructure, cleantech and microfinance. As an active shareholder PGGM engages with companies on environmental, social and governance issues.

Why is sustainability important?

Why do these investors follow a sustainable investment approach? Generally, they expect a higher and more stable, long-term return and, additionally, a responsible return. As universal investors – long-term owners of a diversified investment portfolio spread across the entire market – they have an interest in the quality and continuity of the global investment universe.

PREVI, for example, clearly believes that sustainability issues are important to determine the capacity of a company to generate and preserve value over the long term. Inversely, companies that do not properly manage social and environmental issues are more exposed to risk and may potentially face value-destroying consequences. In addition, it believes that it is in the interest of the members of its pension plan to retire into a world that is characterised by a healthy environment and a healthy society.

As opposed to government pension funds, only a few corporate pension funds have started to integrate sustainability criteria into their investment strategy. Surprisingly, not even the pension funds sponsored by companies which are rated as sustainability leaders, and figure for example in the global Dow Jones Sustainability Index, such as Nestlé, Holcim or Syngenta follow through on this approach.

A non-representative survey I undertook of the pension funds of leading sustainable companies revealed that hardly any of them apply a policy of sustainability to the same level of stringency as the company that has contracted the pension fund. Most of them do not consider sustainability criteria at all.

Of course, there are exceptions: Unilever, a veteran sustainability leader follows a sophisticated responsible investment approach for its pension funds based on exclusion (human rights, controversial weapons, governance), engagement with the management of companies and proxy voting. Similarly, the Novartis pension fund applies exclusion criteria to its shareholdings focused on human rights, weapons and direct business relations with totalitarian regimes.

The seemingly unsatisfactory performance of sustainable investments is often quoted as a reason why pension funds do not consider sustainability criteria in their investment processes. It is the fiduciary duty of pension fund trustees to maximise returns for the beneficiaries of the fund. In that context, return is often wrongly interpreted narrowly with an exclusive focus on short-term share prices and dividends, rather than on long-term sustainable returns.

Sustainable investment strategies tend to show their superior return potential over the long term, as is shown by numerous studies and most recently by a study of the Harvard Business School where the share price performance of 180 companies was analysed over 18 years. Between 1993 and 2011, the portfolio of 90 companies which were at the forefront of implementing sustainability programmes achieved a nearly 50% higher performance than the comparison group.

Pension funds place the highest priority on returns – and they should do. Once pension fund trustees and their investment boards start focusing on the long term rather than the short term – as many of the leading public pension plans already do – they will start integrating sustainability criteria into their investment decisions, benefiting beneficiaries, society and the environment.

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