

Sustainability integration into SAA?

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Pension funds increasingly include sustainability in their investment beliefs. But the next logical step is often missing: inclusion in their SAA (strategic asset allocations).

Sustainability related investment beliefs are most often of a single materiality nature, that ESG issues are relevant to financial risk and return. A minority of pension funds take a double materiality approach, which also aims to improve the way their investments affect outcomes for nature and society. For example, Dutch pension fund PFZW* says that “as a long-term investor we can make a valuable contribution to a more sustainable world. We call this 3D investing.”

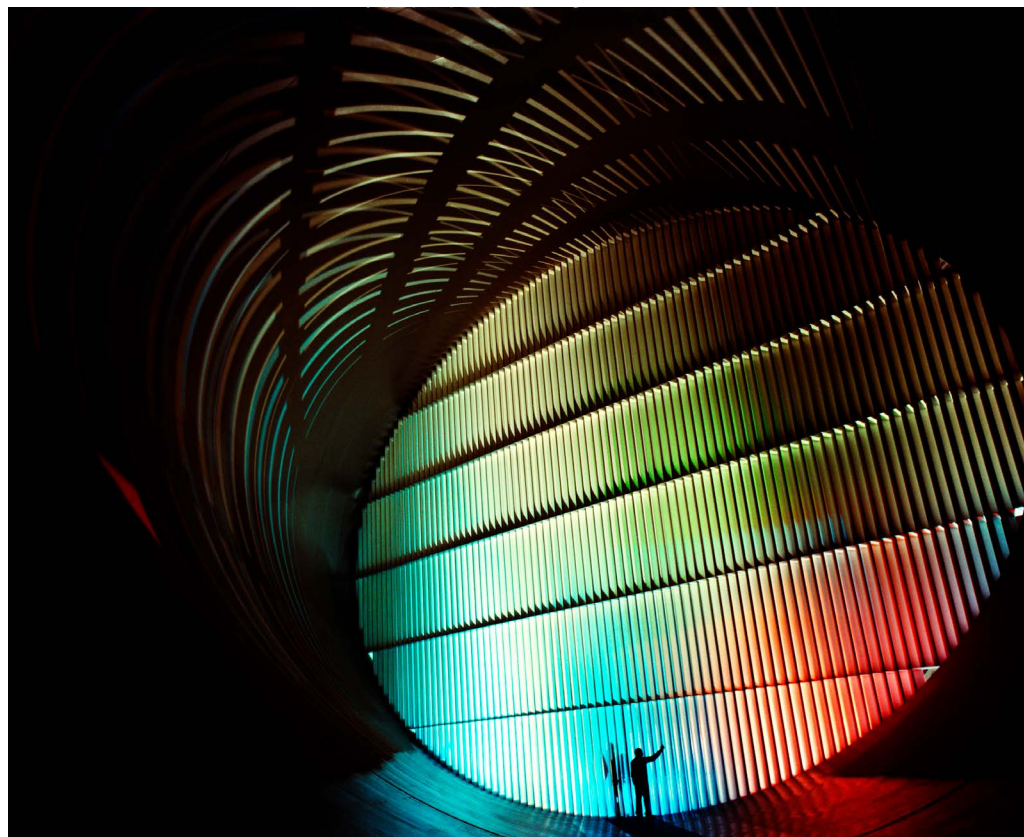
Clearly, the aspiration is there but it is not clear how those investment beliefs result in different long-term risk-return assumptions and allocation choices. Roor, Maas and Schoenmaker (2024) wrote an interesting article on this. In a seminar

at the Schroders Amsterdam office, we discussed the challenges with the authors and with pension fund representatives.

A major challenge is the use of models: long-term models on climate risk are not fit for purpose and it will take years to make them work well. In the meantime, pension funds need to make assumptions. A Nordic client does this by means of stress testing of extreme events; by considering which countries are hit harder; and then adjusting exposures.

Approaching it at a strategic level is crucial: the initiative must be top-down—board, CIO or head of SAA. One cannot expect selection teams to act without a mandate; and even if they have the mandate, they may lack the models and mindsets, which take years to develop. Integrating sustainability in investment beliefs is a start, but the proof of the pudding is in the eating: integration into long-term assumptions and SAA.

Figure 1



* Source: Annual_report_PFZW_2022.pdf

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