



Fiduciary Manager ESG Integration Survey

Progression of the UK fiduciary
managers' approach to ESG integration

December 2024

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Overview and key findings

XPS's survey of the UK fiduciary management market reveals significant strides in the inclusion of environmental, social and governance (ESG) considerations in the fiduciary management of UK pension scheme portfolios. The survey represents over 90% of the market with insights from 16 fiduciary managers. Through-out this summary we refer to ratings that reflect an assessment undertaken by XPS against a formal set of evaluation criteria.

Key points

11%

Green ESG ratings have improved by 11% from the 2023 findings, now at 38%. (See page 2).

30%

Integration of ESG factors has seen the most substantial progress in fiduciary management, with green ratings increasing 30% from the 2023 findings, now at 50%. (See page 2).

81%

of fiduciary managers set a net zero target, which has increased from 74% in 2023 (See page 7).

44%

of fiduciary managers actively influence voting activities of underlying managers increasing from 40% last year. (See page 9)

81%

of fiduciary managers can report on portfolio alignment with the 1.5 degrees Celsius global temperature limit, up from 53% last year. (See page 10).

Trustee checklist

1

Capture your beliefs to outline and set clear priorities to your fiduciary manager.

2

Discuss and understand your fiduciary manager's approach to ESG integration.

3

Assess the alignment between your ESG beliefs and what is being implemented.

4

Scrutinise the extent of integration of ESG practices into your fiduciary management solution and challenge accordingly.

5

Apply oversight to monitor continued development, integration and application of ESG practices.

Introduction

The landscape of ESG investment and sustainable practices is advancing, propelled by heightened reporting standards and investor expectations. In 2024, there has been a considerable surge in the significance of precise ESG reporting, accompanied by a broader spectrum of accessible metrics.

UK fiduciary managers are making strides in refining their solutions, particularly in aiding trustees with reporting mandates such as TCFD, and embedding ESG firmly into their investment policies. Our enhanced survey delves deeper into these solutions, scrutinising the fiduciary managers’ capacity to integrate critical ESG factors. Including 16 fiduciary managers, it represents over £230bn in assets under management in the UK pension fiduciary management space.

This year’s findings are encouraging, with a record 38% of managers attaining an overall green rating awarded by XPS, and notably, no managers receiving a red XPS ESG rating, evidencing an industry-wide effort to advance ESG practices. The most significant progress was seen in integration, which saw a 30% uplift in ratings compared to 2023, with 50% of fiduciary managers achieving a green XPS rating. Reporting and addressing climate change also saw significant gains, with green ratings from XPS climbing to 44% and 63%, respectively. This uplift is driven by commitments to net zero targets, enhanced carbon emissions data, and improved stress testing.

However, the survey indicates a decline in the number of managers rated green by XPS for stewardship, reflecting our elevated expectations in line with rising industry standards. We now expect more rigorous engagement with companies and more impactful investment decisions, underscoring the need for fiduciary managers to bolster their stewardship to deliver long-term value to pension schemes and their beneficiaries.

	Overall			Philosophy			Integration			Climate Change			Stewardship			Reporting		
	2024	2023	2022	2024	2023	2022	2024	2023	2022	2024	2023	2022	2024	2023	2022	2024	2023	2022
	38%	27%	17%	38%	34%	42%	50%	20%	17%	63%	40%	25%	13%	27%	25%	44%	20%	33%
	63%	67%	83%	63%	60%	58%	50%	67%	83%	38%	54%	67%	88%	73%	75%	50%	67%	58%
	0%	6%	0%	0%	6%	0%	0%	13%	0%	0%	6%	8%	0%	0%	0%	6%	13%	8%

Table 1
Breakdown of fiduciary manager XPS Group ESG rating. Percentage of fiduciary managers rated Green, Amber or Red against key areas.
Notes: Figures may not sum due to rounding.



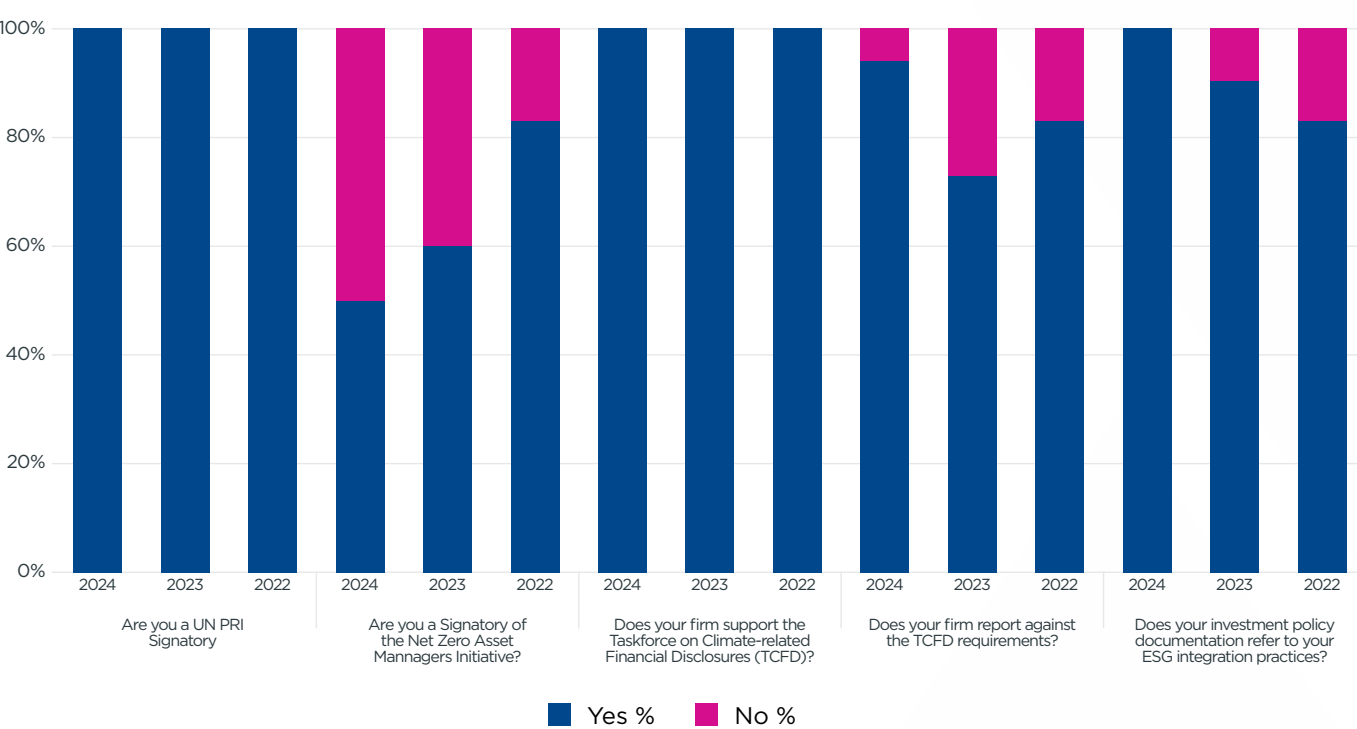
We’ve seen fiduciary managers increasingly hold themselves accountable, not just endorsing but weaving ESG practices into their solutions, as reflected in the improved reporting quality.

Philosophy

Fiduciary managers’ sustainable investment philosophies are increasingly pivotal, blending conventional investment knowledge with ESG insights to enhance long-term client outcomes. These philosophies, reflected in managers’ guiding principles and beliefs, dictate their investment choices and the incorporation of clients’ ESG preferences into mandates.

Affiliation with prominent networks and adherence to industry standards is becoming the norm, as shown in Chart 1. Signatory status to the UN PRI is now a benchmark for ESG leadership. A positive trend is the overwhelming support for the Taskforce on Climate-related Financial Disclosures (TCFD), with over 90% of fiduciary managers reporting against its requirements in 2024, up from 2023. With TCFD compliance becoming mandatory for larger schemes (£1bn+), the commitment to TCFD reporting is vital, especially as reporting may expand to include mid-sized schemes.

Chart 1



Our 2023 survey showed that 60% of managers were part of the Net Zero Asset Managers Initiative (NZAMI). However, this year, none of the previous non-signatories have joined the initiative, and due to an expanded survey sample size, the proportion of NZAMI signatories has reduced to 50%. The industry appears divided on whether joining NZAMI is essential, with newcomers to both the market and our survey opting not to participate.

Our market analysis at XPS has shed light on a couple of the primary reasons for this hesitancy:

- ▶ Many fiduciary managers have independently committed to net zero target and view the additional requirements and formal endorsement of NZAMI as unnecessary given their existing commitments.
- ▶ Other managers, while not part of NZAMI, are engaged with different initiatives. They acknowledge the value of NZAMI and are open to the possibility of signing up in the upcoming years.

Philosophy continued

These insights indicate a shift towards a variety of ESG initiatives, suggesting that the sector is exploring multiple routes to achieve sustainability objectives. This evolving landscape alludes to the potential for a more cohesive approach to ESG practices in time, as the industry gravitates towards global standards that facilitate a collective effort towards net zero.

Building on the ESG commitments dialogue, the UK Stewardship Code's relevance becomes clear. This Code sets the standard for investment stewardship, championing transparency and accountability. It serves as a benchmark for assessing the quality of engagement between institutional investors and the companies they invest in. In our assessment, adherence to the UK Stewardship Code is critical; we only award an XPS green rating to signatories of the Code, highlighting its importance in our ratings process. This underscores our commitment to recognising and endorsing the practices that align with robust stewardship and responsible investment principles.



Fiduciary managers are continuously raising the bar in ESG practices, with a growing number joining key initiatives, setting a standardised approach for ESG metrics across pension schemes. The embrace and reporting compliance with TCFD is promising and will guide trustees in recognising the significance and potential of ESG reporting going forward.



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Integration

While the industry largely adheres to the principles of various ESG initiatives, **the actual integration of these practices into investment strategies shows considerable variation among FMs.**

Proactive ESG tilting, where asset allocation favours securities with strong ESG profiles, is one common method. Others set explicit sustainable objectives alongside financial goals. A universal aspect is the client-centric nature of FMs’ philosophies, as all managers surveyed incorporate ESG considerations from the initial client engagement stage, shaping the objectives of their mandates. However, a persistent challenge is aligning trustees’ beliefs with their fiduciary manager’s investment approach. Therefore, trustees should regularly monitor and raise this with their appointed FM.

Chart 2

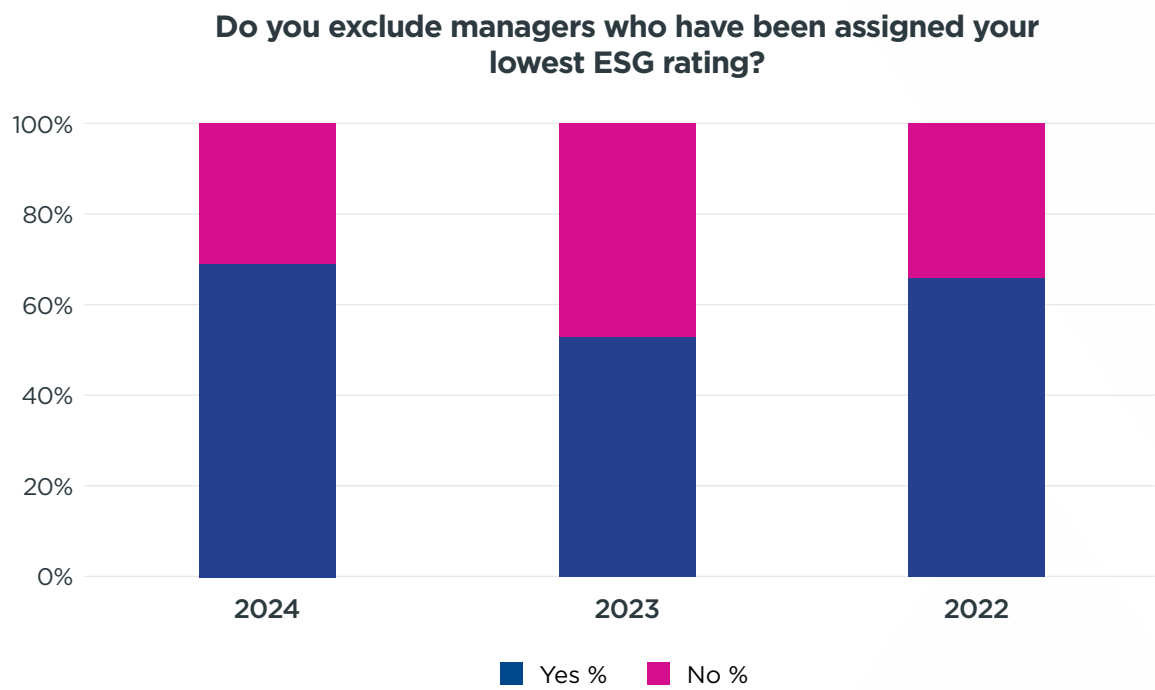
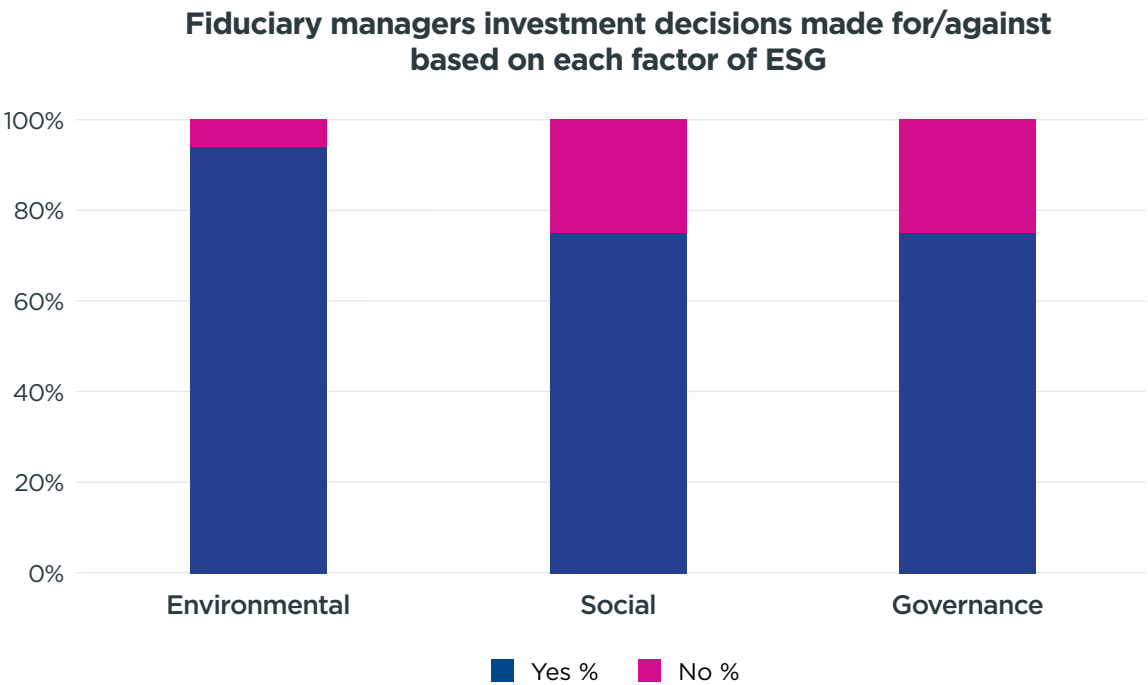


Chart 2 spotlights a significant discussion point: Should fiduciary managers exclude funds and managers that score their lowest ESG ratings from their selection pool? The trend towards exclusion is growing, with more managers adopting this practice than in 2023. Although some fiduciary managers still consider investments with poor ESG ratings within their selection exercise. These managers apply their own ESG criteria in the selection processes. It’s crucial that trustees understand and align with their fiduciary manager’s approach, as it affects their investment portfolio.

Integration continued

Chart 3



Our 2024 survey emphasizes the importance of engagement and decision-making across all ESG dimensions in XPS rating decisions. While environmental aspects often receive the most attention, social and governance factors should be equally weighted in sustainable investment strategies. 94% of fiduciary managers have made investment choices based on environmental factors. However, the aforementioned disconnect is highlighted by chart 3, which shows a stark difference in the percentage of fiduciary managers who have made investment decisions based on social and governance factors.

Each fiduciary manager documented their policy on ESG integration, but the practical application varies widely. Approaches range from screening to activism (leveraging voting rights for corporate engagement) and value integration (incorporating ESG factors into valuation models). Trustees need to be well-informed and comfortable with their fiduciary manager’s specific method of ESG integration.

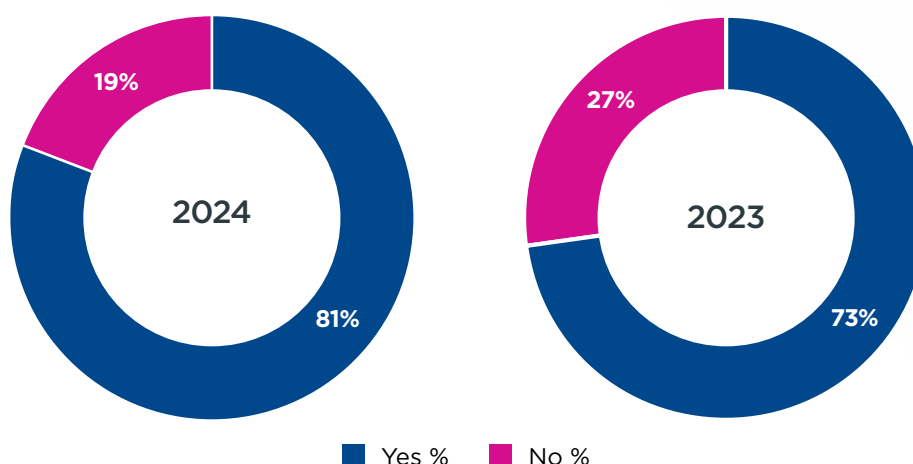


Climate change

The alignment of ESG beliefs, especially on climate change, is becoming increasingly important for pension schemes as they set specific climate-related objectives. This year's survey reveals a marked uptick in fiduciary managers' attention to and actions on climate goals.

Chart 4

Do your solutions have a Net Zero target? Or there any goal to decarbonise/align the portfolio to a climate related benchmark over time?



Encouragingly, there has been a rise in the number of fiduciary managers setting a net zero target, up from 73% in 2023 to 81% in 2024, as displayed in chart 4. However, there's still progress to be made towards making this a universal benchmark. Trustees, particularly those with schemes under fiduciary management with a net zero aim, need to scrutinise the progress their fiduciary manager is making towards achieving this target. This is crucial, especially when the solutions involve underlying managers, as is common in an open architecture approach.

Climate related risk management has been growing with exponential importance over the last few years. Schemes and trustees have been increasingly focused on both the environmental risks impacting their investments and the footprint of their investments on the environment. Our survey has explored how fiduciary managers handle physical and transitional risks and the methods they employ for climate-related stress testing of potential investments. An exemplary case study included below demonstrates fiduciary managers' considerations of physical climate risks.



Case study

How physical related climate risk is accounted for when making investments in the mandate.

"FM 'X' use ISS and MSCI to model climate independently while also relying on data provided by investment managers where they may rely on providers such as EDHEC or data set of insurers to understand risks associated with physical assets.

Through external data vendors, they are able to model physical risk. This produces individual risk scores for factors such as risk of storms, floods, wildfires, droughts, heat stress etc. It also offers a "physical asset Value at Risk (VaR)". FM 'X' are able to assess this risk on a client-by-client basis and decide whether they need to adjust portfolios to manage this risk alongside other risks within the portfolio. As expected, investments in companies or asset classes that own physical assets bring with it increased risks. FM 'X' believe it is important to assess risks holistically and build robust portfolios which will deliver on their long-term objectives."

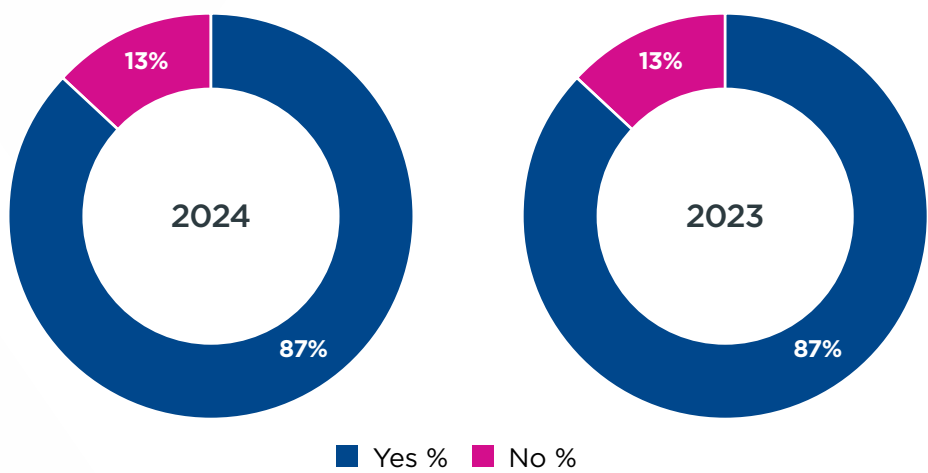
Stewardship

Stewardship stands as a critical lever for trustees to drive positive change within their investments.

Trustees, however, should recognise that, akin to investment decisions, the responsibility for stewardship often passes to underlying managers. Some fiduciary managers maintain power of attorney to enact their own voting policies, but many rely on the policies of third parties or underlying managers. Crucially, fiduciary managers should at least oversee the voting and engagement activities of these managers. Consistent with 2023, chart 5 shows over 85% of fiduciary managers perform such monitoring.

Chart 5

Do you monitor the voting and engagement activity of underlying managers?



Note figures may not sum due to rounding.

Given the importance of stewardship and the ability to affect positive change, we approve of fiduciary managers who actively influence voting activities of underlying managers, with an increase to 44% doing so as shown in chart 6 below. We believe fiduciary managers should exert positive influence on sustainable investment practices and intervene upon identifying poor ESG practices. It's important for trustees to comprehend how their fiduciary managers engage with these underlying managers to effect change.

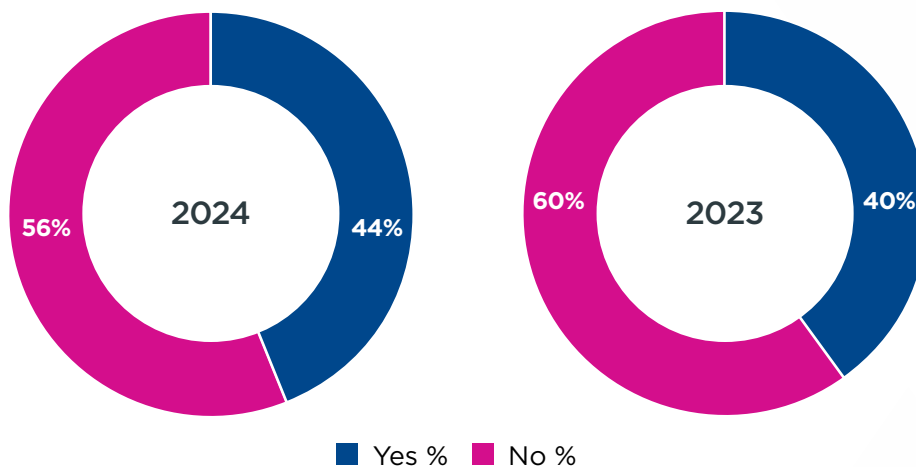


Stewardship continued

The stewardship enacted by fiduciary managers offers a chance to demonstrate their role in promoting ESG principles. Responses between FMs varied in terms of quality and this year that the average overall stewardship ratings from XPS have lowered compared to our 2023 survey. This is partly because, while fiduciary managers have been enhancing their standards, XPS has also elevated its expectations required to ascertain a XPS green rating for stewardship. A key indicator of effective stewardship is the ability to present strong engagement examples, a transparency that is beneficial to clients and trustees. For illustration, we have included a notable case study of social engagement.

Chart 6

Do you actively influence voting activities of underlying assets/managers?



Case study

An example from a FM surveyed of engagement with a sovereign debt fund via an asset management firm 'Company X', advancing a Sovereign's social objectives.

- **Issue:** Around 25% of a Middle East Sovereign's budget is dedicated to advancing social objectives including labour protections, healthcare services, housing programs and jobs support, but there still remain concerns over their practices.
- **Action:** During an onsite country visit to the Middle East, Company X engaged with a variety of government officials around social factors. One key issue under discussion was the Sovereign's commitment to social well-being.
- **Outcome:** Concerns around personal freedom and freedom of expression remain despite progress on issues such as gender equality.
- However, importantly, following a meeting with the Middle East Sovereign's Debt Management Office they sought the fiduciary managers feedback on articulating their ESG efforts in order to provide more transparent information going forward which is a positive signal.

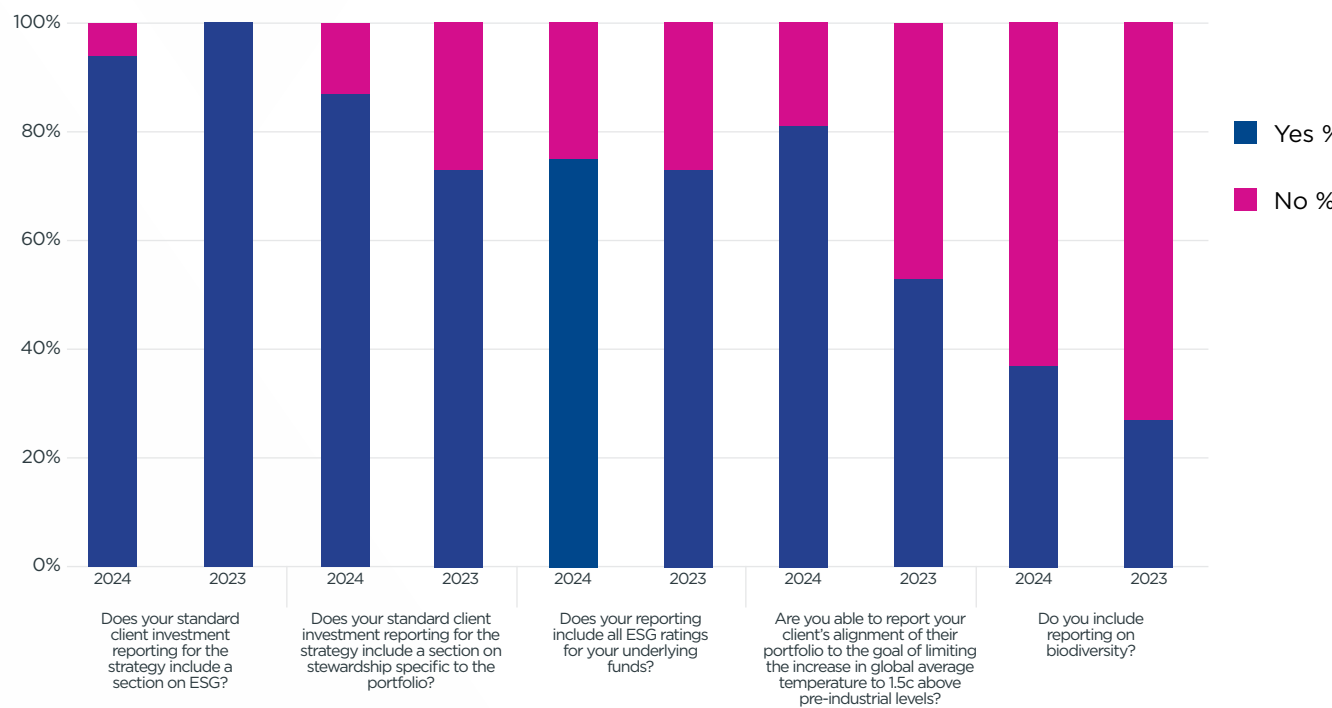
Reporting

As model scenario testing, ESG metrics and integration practices improve, this needs to be accompanied with quality and coherent reporting. Trustees require clarity on ESG metrics that significantly impact their schemes.

Despite improvements in reporting since our 2023 survey, with more fiduciary managers achieving a green XPS rating, it's concerning that specific ESG reporting is not universal, as displayed in chart 7. A notable 13% of fiduciary managers lack a dedicated stewardship section in their standard client reports, a feature we anticipate will become the norm.

The reporting capabilities and the scope of information provided by fiduciary managers differ significantly. Climate change risk often stands out as a key concern for trustees, and data availability on this front has greatly improved. Since our last survey, there is a significant rise in fiduciary managers capable of reporting on portfolio alignment with the objective of limiting global temperature increases to 1.5 degrees Celsius, with the figure jumping from 53% to 81%.

Chart 7



Regulations are steadily driving fiduciary managers to enhance reporting in specific areas. Biodiversity is the latest focal area following the emphasis on climate change, with the World Economic Forum indicating that biodiversity loss is the third most severe global risk in the next ten years. Currently, 38% of fiduciary managers' report on biodiversity, a step up from 27% previously, but this is an area where we anticipate further progress.



Trustees seek to validate their fiduciary managers' efforts in ESG integration, stewardship, and climate strategies. Without clear, detailed reporting, the visibility into their schemes' performance could be obscured.

Summary

Fiduciary management, with its delegation of investment authority, holds a significant share of the UK pension scheme market and continues to gain traction. This model is favoured for its agility in decision-making and its capacity to keep pace with the escalating environmental, social, and governance (ESG) standards in the industry. Fiduciary managers are making strides in enhancing their ESG practices, with notable improvements in reporting quality and deeper integration of ESG principles.

The industry's commitment is clear, with fiduciary managers expected to show tangible advancements in their sustainable practices, not just pledge improvements. This report spotlights both the industry's advancements and areas that fall short of expected standards. It serves as a crucial tool for trustees to evaluate their fiduciary management arrangements and to pinpoint areas where they desire enhancement within their mandates.

Through extensive research, XPS has a comprehensive understanding of best practices, who is advancing the most, and the leaders in the field. We recognise the challenges trustees face in aligning their ESG beliefs with their fiduciary managers' investment strategies. Regular monitoring and dialogue with fiduciary managers is recommended. XPS's growing expertise in this sector positions us to support and advise trustees, whether they aim for compliance or aspire for best practice leadership. We are equipped to guide trustees toward achieving their ESG objectives.



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Find out more

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