THE BLOG

Pension Funds Can't Afford to Be Penny Wise and Pound Foolish

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Divestment from polluting fossil fuel companies is starting to become the order of the day. Examples include the largest pension fund in Washington D.C. which recently announced their divestment of 6.4 billion dollars from 200 of the world's most polluting fossil fuel companies, and the Norwegian pension fund GPFG, the largest investment fund in the world, worth 750 billion euros, also recently stated that they will drop dozens of coal companies from their investment portfolio. These moves mark a significant step toward addressing climate change and it is becoming evident that a movement is underway.

The New Economy

We are undergoing a major economic transition and a fundamental paradigm shift. Society is increasingly turning against everything that is not sustainable. On the risk side, the panels are also shifting. Everywhere in the world, financial experts are calling upon pension fund trustees to divest from fossil energy companies. As U.S. Council Member Charles Allen rightly observed, "Divestment has proven to be an incredibly powerful tool for effecting positive change." This appeal is not only for positive impact reasons, it is the financially sound thing to do. Last year, California's public pension funds lost 5 billion dollars on fossil fuel investments due to the decrease in oil and coal prices.

On the whole, the amount of sustainable investments has increased over the past two years by 60%, with two thirds in Europe. Additionally, in just the last two years, the issuance of green bonds has tripled and this trend is expected to continue in the coming years. We have also seen bold moves this year with the COP-21 agreement and the Sustainable Development Goals agenda, and the declaration that 2016 is the Year of Green Finance.

The Impact of a Collective Movement

The time is ripe for the pension sector to play a decisive role in the sustainability of the economy. In the Netherlands alone, Dutch pension funds jointly manage 1.4 trillion euros -140% of the Gross Domestic Product. That kind of money, together with pension federations from other countries can significantly accelerate the transition to a climate neutral economy. The French fund, the Réserve pour les Retraites, the American CalPERS, the Brazilian PREVI and the Norwegian governmental pension fund are all applying sustainable criteria more often. PGGM offers a good example with the launch of their Responsible Investing in Private Equity Policy. This policy states that all companies that PGGM invests in must have a sustainable agenda or at the very least, they must be working on creating one. This is not only because of an ideological standpoint but also because a sustainable investment policy is profitable as well as cost and risk reducing.

Although the trend is clear, an industry-wide cohesive strategy is lacking. Some pension funds and country-bound federations of pension funds are deciding to move towards sustainability and some are not. In order to turn the tide and have major impact, the global sector as a whole must work together on this movement and it should be based on shared knowledge and a joint implementation agenda.
If all the pension funds collectively developed a more sustainable investment policy, the sector as a whole would create far more social value than is currently the case and could expect a clear positive impact on investment results as well.

However, some pension funds are still holding back. The most recent benchmark of the Dutch Association of Investors for Sustainable Development (Nederlandse Vereniging van Beleggers voor Duurzame Ontwikkeling VBDO) shows that the movement towards more sustainable investments is not being embraced by all. And this is not only happening in the Netherlands. ABA, the German pension federation has recently announced that they will assign less priority to environmental, social and governance factors (ESG) due to the current problems from low interest rates. The ABA justifies this decision by arguing that "The certainty of investments yielding the necessary returns for investors is more important than ESG factors.”

This is old thinking at its best and it contradicts the essence of what is at stake. Institutional investors should in fact take ESG factors into account for reasons of risk management and the long-term interests of the participants. The viability of pensions depends on sustainable economic growth. It is therefore crucial that pension funds apply new principles to their investment policies.

Capital for Good

The re-direction of capital is crucial to accelerate this transition. What we invest in, will grow; what we divest from, will phase out - and it should. In a recent WEF survey, 750 economists said that they see a climate-induced catastrophe as the greatest threat to the world economy in 2016. Thankfully, we are already seeing a strong divestment from fossil fuels and an increase in the growth of sustainable capital and sustainably responsible investing, as there are increasing indications that previously considered risky investments in sectors such as cleantech, are now leading to above average returns.

Although we are making strides, more can and should be done in the sector as a whole. All businesses, including pension funds, must aim to create a positive impact on all the assets of the world and contribute to developing an economy that is here for the world and leave behind the exploitation of a world serving the economy. No one can afford to be penny wise and pound foolish. Pension funds, with their inherent long-term interests, least of all.

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