

Environmental, Social, Governance, and Sustainable Development Issues for the Arab Pension Funds

Findings from a regional Survey



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ACRONYMS AND ABBREVIATIONS

AMER	North, Central and South America
AMF	Arab Monetary Fund
APAC	Asia Pacific
CFA	Chartered Financial Analyst
ESG	Environment Social and Governance
ETF	Exchange Traded Fund
GMO	Global Solar Market Outlook
GPIF	Japanese Government Pension Investment Fund
ICMA	International Capital Markets Association
MEA	Middle East and Africa
MENA	Middle East and North Africa
NDCs	Nationally Determined Contributions
TFCF	Task Force on Climate-Related Financial Disclosures
SDGs	UN Sustainable Development Goals
SSE	Sustainable Stock Exchanges Initiative
UNDP	United Nations Development Program
UNEPFI	United Nations Environment Programme Finance Initiative
UNPRI	UN Principles for Responsible Investment
WBG	World Bank Group

EXECUTIVE SUMMARY

This report provides the results of a regional survey of Arab pension funds and their current level of engagement with Environment, Social and Governance (ESG) issues¹ as a means for these funds to help achieve the UN 2030 Agenda for Sustainable Development and its Sustainable Development Goals (SDGs)².

It uses a survey and dialogue with the funds to assess ESG – and eventually SDG – integration into their investment strategy and the way in which they operate. These findings are put into global and regional context, highlighting the importance of owners of capital like pension funds adopting ESG issues.

This report is the result of a joint engagement between the Arab Monetary Fund (AMF) and United Nations Development Program (UNDP)

to support Arab countries as part of global and regional efforts to achieve the SDGs through integrating ESG frameworks into pension fund investment decision. In this context, pension funds in the region were approached through Arab Ministries of Finance. The results in the report are based on the 14 funds in 10 countries who participated, with over USD \$200 bn in total assets³.

The survey created a 'maturity matrix' for each pension fund.⁴

This assessed their position in one of 4 levels:

- **Level 1:** Having basic knowledge and understanding;
- **Level 2:** Having adopted a strategy to integrate ESG issues;
- **Level 3:** Active engagement internally and externally on the issues;
- **Level 4:** Active and deep implementation of ESG issues.



The funds were assessed against these four levels on five main dimensions:

- **Integration** – How far ESG factors are integrated into investment decision making, familiarity with the UN SDGs and whether they had also been integrated into the scheme approach.
- **Members and sponsors** – How actively the scheme is engaging and understanding its "internal" stakeholders, such as beneficiaries and sponsors, on ESG issues.
- **Advisors** – How actively the scheme is engaging its external advisors and service providers and expecting them to align and support the scheme on ESG issues.
- **Stewardship** – What level of active ownership is being undertaken and how e.g. in relation to voting on corporate resolutions, and how are these activities monitored and reported.
- **Climate risk management** – Awareness of the Task Force on Climate-related Financial Disclosures and if its recommendations, including climate scenarios analysis, had been implemented.

¹ "ESG factors are conditions, circumstances, or issues that can be found in areas such as energy consumption, greenhouse gas emissions, climate change, resource scarcity, water use, waste management, health and safety, employee productivity, diversity and inclusion, supply chain risk management, human rights (including workers' rights), and effective board oversight" (Harvard Management Company). ESG Integration is "the explicit and systematic inclusion of material environmental, social and governance (ESG) factors in investment analysis and investment decisions that are material to investment performance, i.e. with a view to lowering risk and/or generating (financial) returns" (adapted from PRI and IFC, <https://ifc-org.medium.com/the-difference-between-esg-and-impact-investing-and-why-it-matters-8bf459b3ccb6>).

² The 17 SDGs are a universal call to action to 'end poverty, protect the planet, and ensure that by 2030 all people enjoy peace and prosperity'

³ Note that the exact total of Assets under Management (AUM) will be higher but some funds do not publicly disclose their AUM and did not provide it in response to the questionnaire. In addition, 3 schemes did not currently have any assets – although some were expecting to build assets in the future.

⁴ The findings in this report are provided in aggregate or with the pension funds anonymized. The pension funds that participated in the survey were given specific individual responses.

The key findings from the survey were:

- The majority of schemes have not integrated or are at early stages of integrating ESG into the investment strategy and process.
- There was a range of experience, with five schemes operating at the higher levels of maturity of ESG integration, although for some it is possible that the true level is somewhat lower⁵.
- Thus far, there was no clear evidence of significant integration or active discussion of the SDGs by the pension funds, although 10 of the 14 surveyed funds had 'noted the SDGs but not discussed in detail'. However, there was more active discussion on ESG issues, which can help funds establish stronger linkages with the SDGs.
- Of the schemes that had integrated ESG, 'Integration' was consistently the highest scoring theme (at 'Implementation' level 4) with 'Climate risk management' the lowest (at 'Knowledge and Understanding' maturity level 1).
- The most valuable tools to aid integration that were cited are support for the development of peer networks, and case studies that could be allied to expert assistance to enable pension funds' leadership and staff to develop their approaches.

On the basis of the survey findings and the global and regional context, this report sets out a range of recommendations⁶.

These are for national government and regulatory authorities, pension funds, global and regional development institutions and advisers who want to help pension funds in the Arab region move forward on their ESG journey. The support needed is varied, given that some pension funds are right at the start and others have already given the issues significant attention. For all funds, however, there are further steps that can be taken, and the aim of this report is help increase the attention, information and support available.

⁵ The survey answers are internal and can reflect a perception of level of integration which does not fully reflect reality.

⁶ The maturity map is dependent on the pension fund self-assessment. Key information was checked and gaps probed, but the process is not as in-depth as an individual assessment with multiple face to face meetings and a chance to observe and test the processes and approaches at first hand. On the other hand, the survey allows more schemes to be compared. It also starts the process to build the discussion on ESG and the SDGs with more schemes in more countries, which is one of the objectives of the project. As highlighted in the recommendations, an important step for a number of funds would be to have the personalized and in-depth assessment that would provide a more detailed action plan for change.

The recommendations are focused on steps that can be taken by governments and regulators, pension funds, global and regional organizations and pension fund advisors to deepen the integration of ESG and the closely linked SDGs into pension funds in the region.

For Governments and regulators to:

- Propose a roadmap for companies (and funds) to adopt the recommendations of globally recognized reporting practices⁷ as a first step to stimulate the provision of ESG and SDG related data and information for pension funds.
- Adopt the approach set out in the International Organization of Pension Supervisors (IOPS) 'Supervisory Guidelines on the Integration of ESG Factors in the Investment and Risk Management of Pension Funds'.
- If needed, revise national legislation and regulations to ensure the pension fund legal remit allows ESG integration as a key part of delivering fiduciary duties to members and also ensures the right mix of support and powers to regulators and ministries to ensure ESG and SDG impact standard adoption⁸.
- Ensure that national investment regulations applied to the pension funds do not prevent them from investing overseas as this may be conducive for some funds to achieve further progress on ESG alignment⁹.
- Ensure that ESG integration clearly delivers better reporting of enterprise and investor impacts on people and planet.
- Develop internal capacity to understand and utilize ESG and SDG impact standards.

⁷ Examples of global principles and practices are as follows: UN PRI (www.unpri.org), GRI Standards (www.globalreporting.org), the International Integrated Reporting Framework (<https://www.integratedreporting.org/resource-type/technical/>), SASB (<https://www.sasb.org>), the Climate-related Financial Disclosures (TCFD - <https://www.fsb-tcf.org/>), etc.

⁸ For more information about the SDG Impact standards, please see <https://sdgimpact.undp.org/assets/About-the-SDG-Impact-Standards.pdf>

⁹ Note that the overall policy framework in a country can also be reformed to ensure that the economy as a whole will be aligned to achieve the SDGs and ESG outcomes. This report focuses only on the pension specific aspects.

For the pension funds to:

- 1 Develop their internal capacity and access to advice to show how the lack of integration of ESG factors rooted in the 2030 Agenda and SDG impact principles may undermine investment strategies and outcomes and how to ensure ESG factors are embedded into SDGs-conducive strategies, and implemented, monitored and tested accordingly.
- 2 Commit that the next iteration of their investment strategy will incorporate ESG factors and, progressively, impact standards within the Agenda 2030 principles and framework.
- 3 Create robust internal impact management systems. Organizations that adopt the ESG and SDG Impact Standards may be in a better position to meet growing sustainability reporting and disclosure requirements.
- 4 Require advisers to integrate ESG factors into investment strategy or acquisition advice.
- 5 Ask companies in which the pension fund is invested for ESG disclosures and ensure the funds make these disclosures too (until national legislation requires it as recommended above).
- 6 Improve transparency and disclosure of ESG issues and SDG impact standards, with clear communications to members on the benefits of the changes and how they support fund performance.
- 7 Engage actively in new peer networks and conduct ESG and SDG integration readiness assessments.

For global and regional stakeholders¹⁰ to:

- 1 Support the development of a peer network in the region that allows pension schemes to collaborate and share best practice for ESG integration, and to raise the profile of the SDGs.
- 2 Support the creation of regionally relevant case studies and guides with clear practical advice.
- 3 Provide access to qualified advisors able to provide advice to scheme management and Boards on integrating ESG into investment; and to governments and regulators on the changes they need to make (as highlighted above) to enhance ESG and SDG focus by funds.
- 4 Support the development of tools and guidance to monitor advisors so that funds can appraise them on ESG expertise when procuring their advice and monitoring them on an ongoing basis.



- 5 Support the design and roll out of ESG financial investment products that are also Shariah compliant – working with regulators, pension funds and sustainable stock exchanges.
- 6 Continue global and regional work to harmonize SDG and ESG data and indices.

For pension fund advisers to:

- 1 Ensure that their advice to the pension funds is clearly and transparently integrating ESG and SDG impact standards into the core investment process and that they have the tools, data and expertise required to assist the pension funds¹¹.

¹⁰ The Global and Regional Stakeholders and initiatives are discussed in detail in Section 2 and include UNDP at a global level and the Arab Monetary Fund at a regional level.

¹¹ There is no single uniform set of tools to mandate, but advisors should be able to show how they are integrating the latest global and regional best practice on relevant framework and tools – as identified for example in Section 2 and 3 and in the supporting references. Moreover, given the fast-moving pace of expertise and frameworks in this area, advisors will be expected to show how their approach is developing in sophistication and precision over time.

1/ INTRODUCTION

RATIONALE FOR THE STUDY AND BACKGROUND ON SDGS AND ESG



This report focusses on Environmental, Social and Governance (ESG) investing in Arab Pension Funds.

It does so because improvements in relation to ESG by investors, including pension funds, are an important means to deliver the best outcomes for the members of pension funds (see Box 1 and Annex B) as well as to help investors contribute to the achievement of the UN Sustainable Development Goals (SDGs). The SDGs were adopted by the United Nations in 2015 as a part of the 2030 Agenda. They are a universal call to action to 'end poverty, protect the planet, and ensure that by 2030 all people enjoy peace and prosperity'¹².

THE IMPERATIVES OF FINANCIAL SECTOR IN SUSTAINABLE DEVELOPMENT

Human activities have significantly altered natural environments across the globe and transformed ecosystems on which human livelihoods and well-being depend. Addressing these pressing environmental, climate, and social challenges involves nothing less than a structural transformation that sets economies on a sustainable and inclusive path to meet the global ambition of achieving carbon neutrality by 2050 (Paris Agreement) and the 2030 agenda. The financial sector is a pivotal component of this transition and has a stake both in mitigating sustainability-related risks, building resilience and channeling capital to sustainable uses.

There are 17 SDGs which are interconnected, since action in one can affect achievement in others(see Figure 1). They also have a long-term focus aiming to ensure that any developments are sustainable for current generations and those to come.

This makes the focus on ESG issues rooted within the 2030 Agenda framework particularly important since reductions in poverty, for example, cannot be sustainably delivered if they come at the expense of destroying local areas or the damaging the global climate¹³. Countries have committed to prioritize progress for those who are furthest behind. The SDGs address the global challenges we face including poverty, inequality, climate change, environmental degradation, and peace and justice. All groups in society will need to contribute – from governments and companies to local communities and individuals.

¹² <https://sdgs.un.org/>

¹³ Without embedding ESG within the SDGs and the 2030 Agenda, there is a risk that useful initial steps taken to improve ESG will not develop into a necessarily broader framework articulated by the SDGs and the Impact Standards. This framework builds on, and importantly extends the ESG factors to have a much broader definition of impact and the potential benefits for people and the planet. See for example: <https://ifc-org.medium.com/the-difference-betweenesg-and-impact-investing-and-why-it-matters-8bf459b3ccb6>

SUSTAINABLE DEVELOPMENT GOALS



Figure 1: The Sustainable Development Goals

Source: United Nations

The Addis Ababa Action Agenda (AAAA) on Financing for Development was adopted in 2015. *‘It provides a new global framework for financing sustainable development by aligning all financing flows and policies with economic, social and environmental priorities’*¹⁴.

It committed the international community to take steps to mobilize in the face of multiple challenges, including the risks to which the financial sector is exposed. In addition to environmental and climate risks and those posed by social pressures, recent events have shown how contagious diseases and outbreaks such as COVID-19 pandemic can create a global crisis. In the 2020 World Economic Forum Global Risks Report, the top five risks in terms of likelihood were all environmental risks. In terms of impact, the single greatest risk facing humanity was identified to be the failure to mitigate and adapt to climate change (World Economic Forum, 2020). In addition, the Bank for International Settlements (BIS) warns that, if not managed properly, climate-related risks could not only threaten the stability of financial institutions, but also lead to a systemic financial crisis.

Likewise, sustainable financial systems can contribute to the goal of sustainable and inclusive economic development by promoting business innovation and strengthening the economic, environmental and socially responsible behavior of businesses.

Businesses need access to capital, credit or equity to expand and grow their businesses. By setting the right incentives through non-financial lending and investment criteria, the financial sector acts as a ‘multiplier’ of responsible business practices and sustainable economic development. Consequently, Responsible Finance cannot be decoupled from the responsible business agenda as it is ultimately a means to the latter.

In addition, while the financial sector faces many risks related to sustainability challenges, the transition to responsible financial services also creates many opportunities.

For instance, in emerging markets alone, national commitments under the Paris Agreement would require more resources from all sources and deploy more than USD \$20 trillion between 2016–2030 in developing countries that represent almost 50% of global greenhouse gas (GHG) emissions¹⁵. This will include investments in renewable energy, low-carbon cities, energy efficiency, and climate-smart agriculture (International Finance Corporation). As estimated by the Climate Policy Initiative, climate-related financial flows have increased in recent years, exceeding half a trillion US dollars in 2018, but still fall far short of global investment needs.

¹⁴ Financing for Sustainable Development (un.org).

¹⁵ UNEP 2017a.

OPPORTUNITIES AHEAD

Public spending alone will not be sufficient for the large-scale capital needed for a low-carbon economy, to mitigate the effects of climate change, support solutions for climate adaptation, and reduce global greenhouse gas emissions.

The financial industry is expected to play an instrumental role as the need for climate finance is more urgent now than ever before. It is therefore important to align the financial system, both banking, non-bank financial institutions and capital markets, with sustainable development. This will pose new challenges to central banks, regulators and supervisors. Barriers at policy, macro and microeconomic levels, such as those pertaining to strategic policy priorities, regulatory framework conditions and capital markets, require actions by financial system actors at all of these levels.¹⁶

There is a window of opportunity for every country to design policies that promote responsible financial services and build sustainable and inclusive economies that are resilient to environmental degradation, climate change, and social pressures.

Today, Central Banks worldwide recognize the seriousness of social and environmental related financial risks and consider them in support of the 2030 Agenda as part of their mandate. In fact, there are growing efforts to integrate environmental and social sustainability in financial market policies, processes and practices, from green bonds to national responsible finance strategies and action plans. However, building a sustainable financial system requires a comprehensive, systematic, and coordinated approach that governments, financial regulators, supervisors, and market players around the world are finding challenging to adopt and implement.

Policymakers, development organizations and sector-specific experts are currently discussing how responsible finance providers are driving sustainable development.

This includes the alignment with the SDGs and the increasing interest in impact investing, and their future role in a world where inclusive and sustainable growth will be paramount. Prior to the pandemic, the UN estimated that the Arab region as a whole would need an additional \$2 trillion by 2030 to meet the SDGs¹⁷.

An important contribution to help investors and companies contribute in a positive way to sustainable development and the SDGs are the 'SDG Impact Standards', developed by SDG Impact, as a UNDP initiative¹⁸.

'The Standards are decision-making standards, not performance or reporting standards. They are designed to help organizations integrate operating responsibly and sustainably and contributing positively to sustainable development and the SDGs into organizational systems, investment frameworks and decision-making practices, using a common language and shared approach to do so'.

They are forward-looking management standards and provide a unified management approach to the advancement of the SDGs amongst businesses, investors and policy makers. Having a common approach to sustainability management makes it easier for different actors across the economy to connect and encourage cross-sector collaboration and innovation¹⁹. The SDG Impact Standards are part of a wider range of initiatives developed by UNDP's SDG Impact that also include SDG Impact Training, SDG Investor Maps, Interactive SDG Investment Platform and SDG Impact Investor Convenings and Policy Dialogue²⁰.

¹⁶ Berensmann / Lindenberg 2017, GFSG 2016, Glemarec et al. 2015.

¹⁷ UN ESCWA, The state of financing development in the Arab region, 2018.

¹⁸ <https://sdgimpact.undp.org/assets/About-the-SDG-Impact-Standards.pdf>

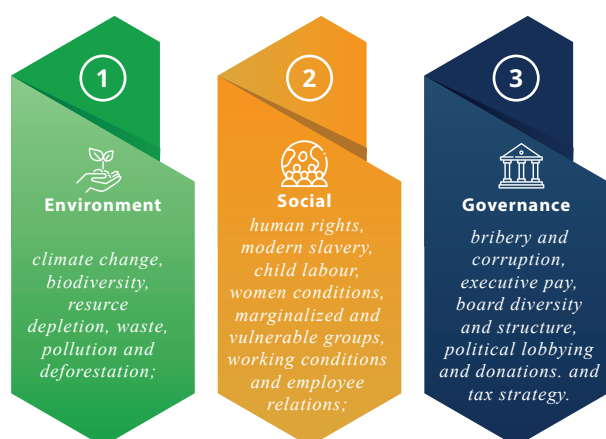
¹⁹ Good management precedes good reporting. By creating robust internal impact management systems, organizations that adopt the SDG Impact Standards will be in a much better position to meet growing and various sustainability reporting and disclosure requirements.

²⁰ <https://sdgimpact.undp.org/assets/SDG-Investor-Maps.pdf>

THE ROLE OF PENSION FUNDS FOR ESG AND SDGS

Pension funds – like other investors – have a profoundly important role to play in helping to achieve the SDGs because of the huge resources they control and the impact that investing has on countries, companies, people and the planet²¹.

The close association between the SDGs and ESG factors can be seen by looking at the type of issues covered when a pension fund starts to consider them. Looking at each of the ESG factors in turn the issues include, among others²²:



Therefore, pension funds that incorporate ESG and SDG impact standards into their investment strategy would, by default, starting to align their assets with SDGs, as they reflect on environmental, social, and governance issues.

For example, a pension fund that has integrated ESG values based on the 2030 Agenda framework and principles into its investment strategy and invests in a company that sets different environmental goals, such as achieving net zero greenhouse gas emissions, will likely contribute to progress towards SDG 13 while trying to contribute in parallel towards all other SDGs. Figure 2 maps ESG to the SDGs.

Box 1: Evidence on the financial performance of ESG strategies (See Annex B for full details.)

A growing body of evidence is slowly alleviating historic concerns that ESG investing sacrifices financial return. Studies are beginning to better understand the corporate financial performance of companies with a strong ESG practice due to availability of data sets that track ESG performance over a longer timescale. A significant amount of this research is finding a positive correlation between a company's ESG performance and corporate financial performance. This trend is largely attributed to the better risk management, sustainable business practice and generally well managed nature of these companies.

A review of more than 1,000 research papers published between 2015 - 2020 analyses the relationship between ESG and financial performance and concluded 1:

- Financial performance due to ESG is more noticeable over longer time scales
- ESG integration performs better than negative screening
- During social or economic crises, ESG is effective at protecting from downsides
- Improved financial performance in corporations with better sustainability practices is attributed to improved risk management and more innovation
- Better financial performance was identified for corporates and investors who were anticipating a low carbon future
- ESG disclosure alone does not result in enhanced financial performance, broader ESG practice (such as monitoring a firm's ESG performance metrics) was more likely to improve balance sheets.

1 Whelan, T, Atz, U., Van Holt, T., Clark, C., 2021, ESG and Financial Performance: Uncovering the Relationship by Aggregating Evidence from 1,000 Plus Studies Published between 2015 - 2020, Online.

²¹ Indeed, for many individuals, the largest asset they own except for their home will often be their pension. In many pension plans in the GCC individuals do not have direct choice over their investment strategy, so it is even more important that those responsible for the stewardship of pension assets ensure member benefits and ESG issues are aligned.

²² UN Principle of Responsible Investment 'An Introduction to Responsible Investment'. <https://www.unpri.org/an-introduction-to-responsible-investment/what-is-responsible-investment/4780.article>.

Aligning pension investments to ESG and the SDGs is also driven by the central purpose of a pension fund to ensure that promised pensions are paid. This entails a clear focus on the risk and return of different investments and how they match to the objectives of the pension fund.

It is increasingly clear that taking account of ESG and SDGs contributes to financial performance for investors, including pension funds. Box 1 sets out the highlights on the evidence that an ESG focus can improve results, with full details in Annex B. The flip side of this positive story is that not considering ESG and SDGs may damage a fund's financial performance. Large financial risks are taken with member assets if pension funds do not take account of these. This includes the impact of clean-up costs of environmental accidents, the costs of consumer boycotts if investee companies do not take account of their impact on the environment and their workers and on fraud and company failure of weak governance. All of these, and many other risks, are material to the financial performance of pension funds.

As highlighted in Section 2 on Global and Regional Initiatives there are many different ESG reporting and rating systems and initiatives. These range from the Task Force on Climate Related Financial Disclosures, the Principles from the International Corporate Governance Network and the Global Reporting Initiative Standards and Reporting tools.

In addition, Section 2 also highlights the different commercial rating systems that exist that can be used by pension funds and other investors that seek environmental, social or governance specific indices to differentiate within and between different asset classes, countries or regions. The picture is still developing, and there are challenges to align all the signals from different indices. However, there is much greater evidence on the benefits of ESG, supply of investable projects and demand for ESG and SDG integration now than ever before.

Pension funds aligning with the ESG standards can map the SDGs-ESG in order to link the two sets of standards and goals in their strategy.

Further to reporting of financially material²³ ESG factors, which does not guarantee per-se alignment with the SDGs²⁴, adoption of the SDG Impact Standards²⁵ will add a focus on internal management systems that integrate operating sustainably and contributing positively to the SDGs into all business and investment decision-making. Therefore, issues of scope and ambition in the impact on the SDGs need to be analyzed. A holistic view is important so that activity with a positive social impact, for example, will not have negative impact on other critical dimensions such as the environment. This will enable pension schemes to track their impact on the SDGs and help advance the 2030 Agenda.

There are many examples of how pension funds have integrated ESG factors in practical terms that are identified throughout this report and Box 2 (page 45) provides an anonymized example of current practice for a leading pension fund in the region.

For some it is investing in global or regional 'ESG' indices for bonds or equities rather than just the standard non-ESG bond and equity indices. Some may take a more proactive approach to the governance of their investee companies and vote proactively as shareholders and proactively engage with the management of the companies to improve their ESG performance. Others may target improving the conditions in the supply chain, or move away from investments that have a negative environmental impact – for example in relation to unsustainable Palm Oil plantations, deforestation or investments in coal fired power stations. Some funds will be able to move to the next level when they will be able to fully integrate ESG and SDG factors into their investment strategies – but the examples above and throughout the report show that there are practical steps that any fund can take to move their ESG considerations forward towards the achievement of the 2030 Agenda.

²³ The consideration of sustainable development issues (risks and opportunities) that are deemed to be financially material to enterprise value (i.e. as opposed to those broader issues that are material to sustainable development and the achievement of the SDGs, or to the stakeholders experiencing the impacts and go beyond strictly financial aspects). <https://sdgimpact.undp.org/assets/SDG-Impact-Standards-Glossary.pdf>

²⁴ The explicit and systematic inclusion of material environmental, social and governance (ESG) factors in investment analysis and investment decisions that are material to investment performance, i.e. with a view to lowering risk and/or generating (financial) returns is only one part of an ESG focus which then needs to be broadened over time to ensure a full consideration of the potential impacts on the SDGs which include many links to ESG factors but are broader and deeper.

²⁵ The SDG Impact Standards aim to move organizations from SDG alignment to SDG action. "The Standards are decision-making standards, not performance or reporting standards. They are designed to help organizations integrate operating responsibly and sustainably and contributing positively to sustainable development and the SDGs into organizational systems, investment frameworks and decision-making practices, using a common language and shared approach to do so..." "The Standards are organized around four interconnected themes – strategy, management approach, transparency, and governance – each of which plays an important role in fully integrating sustainability and contributing positively to the SDGs into organizational systems and decision making". <https://sdgimpact.undp.org/assets/About-the-SDG-Impact-Standards.pdf>



Figure 2: Mapping the SDGs to ESG factors

Source: understanding SDGs in sustainable investing (www.berenberg.de)

Mapping of the SDGs to the different elements of ESG can help show where the main impact may occur. However, many SDGs will have impacts across more than one part of ESG as shown in Figure 3.

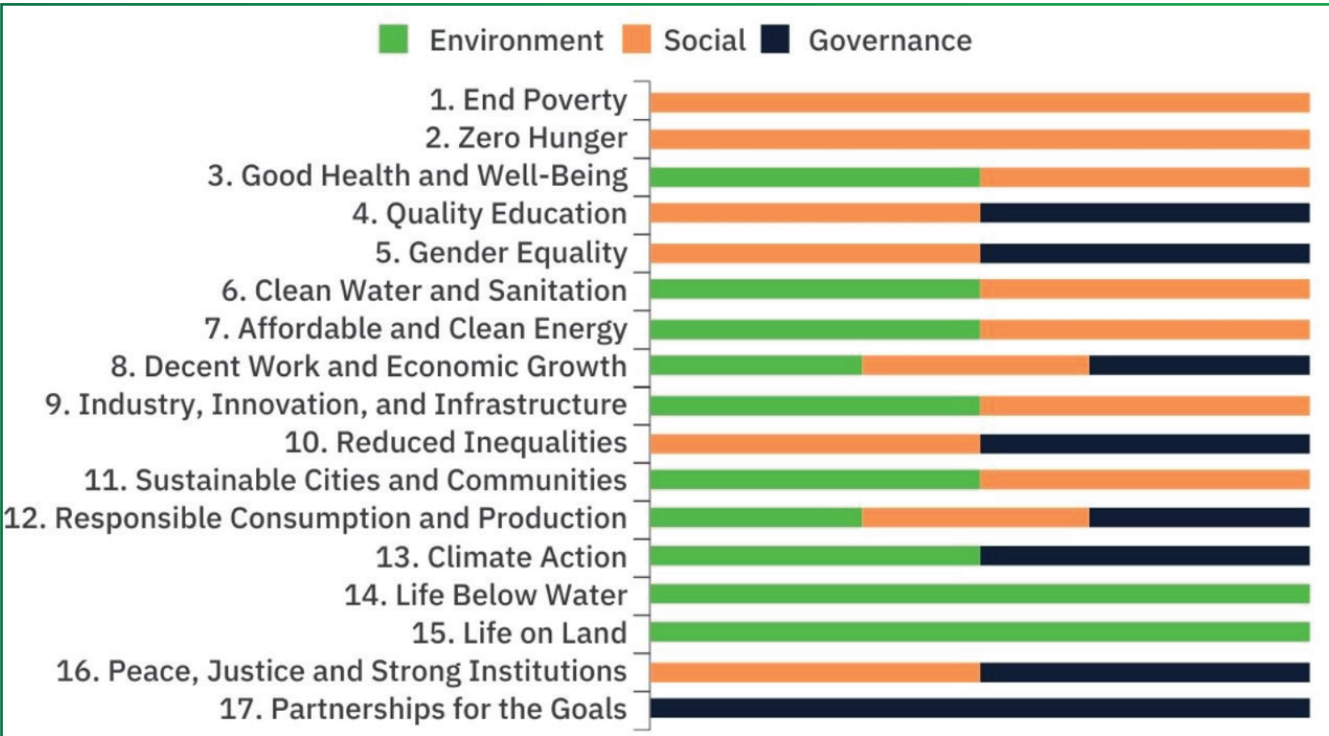


Figure 3: Impact of the SDGs on ESG factors

Source: What Are The 17 UN SDGs And Why Do They Matter For ESG?

Pension fund investors can be placed in a spectrum of different types of investors (see Table 1).

Pension funds are not philanthropic ventures at one end of the spectrum aiming to support a particular cause (outside of their core duty to deliver good pensions for their members). At the other end of the spectrum they are not just ‘conventional’ financial investing vehicles that can ignore ESG issues even when they are material to the performance of the pension fund. Instead, they sit in the middle of the spectrum – most typically aiming to demonstrate ‘Sustainable and Responsible Investing’ to reflect the modern understanding of the factors that need to be assessed to deliver the best long-run outcomes for pension fund members.

In other words, the ‘fiduciary duty’ of a pension fund trustee or board members is entirely consistent with the integration of ESG issues and SDGs into the investment strategy. These issues are examined in more detail at Annex A on Fiduciary Duty and Annex B on Traditional versus ESG investing. Even though fiduciary duty and a focus on ESG and SDGs are clearly consistent, in some countries the legislation, regulation or case law can create concerns for those running pension funds that cannot consider ESG issues. In these cases, legal changes can bring clarity and certainly that the two responsibilities are aligned in legal as well as theoretical terms.

	Philanthropy		Social Impact Investing		Sustainable and Responsible Investing ⁸	Conventional financial investing
	Traditional Philanthropy	Venture Philanthropy	Social Investing	Impact investment	ESG investing	Fully commercial investment
Focus	Address societal challenges through the provision of grants	Address societal challenges with venture investment approaches	Investment with a focus on social and/or environmental outcome and some expected financial return	Investment with an intent to have a measurable environmental and/or social return	Enhance long-term value by using ESG factors to mitigate risks and identify growth opportunities.	Limited or no regard for environmental, social or governance practices
Return Expectation	Social return only	Social return focused	Social return and sub-market financial return	Social return and adequate financial market rate	Financial market return focused on long-term value	Financial market return only
	Social impact		Social and financial			Financial returns

Table 1: Comparing the different roles of asset owners

Source: OECD 2019, Social Impact Investment, the Impact Imperative for Sustainable Development

For these reasons, the AMF and UNDP launched a survey to baseline the current level of understanding and use of ESG and SDGs among major pension funds in the Arab region.

The process for identifying the fund, developing a questionnaire to assess current approaches to ESG and reviewing the results is outlined in Section 3. Before this detailed discussion of the survey and the results, the report first puts the debate in its global and regional context.



2. GLOBAL AND REGIONAL TRENDS ON ESG AND SDGS

2. GLOBAL AND REGIONAL TRENDS ON ESG AND SDGS

GLOBAL INITIATIVES – G20 AGENDA ON CLIMATE AND ESG AND THE SDGS AGENDA

The Arab World, as it is the case for the rest of the world, is vulnerable to climate change. There are pressing mitigation and adaptation needs related to issues such as water scarcity, rising sea levels, drought, land degradation and desertification.

Climate change is expected to have repercussions on the region's food, energy and water security through its negative impact on vital sectors including, but not limited to, water, health, coastlines, tourism and agriculture in a region where more than 50% of food is imported and most of its population is still rural and dependent on agriculture for its livelihood.

The SDGs highlighted in Section 1 have become a key organizing framework for action across the world on a wide range of topics.

The intersection of ESG, sustainable finance and the SDGs is critical. As Figure 4 shows, there are many groups collaborating in various ways to support sustainable and responsible investments, from global and regional development organizations, think tanks, industry, consumer and advocacy groups. The impact management platform is a collaboration between leading providers of public good standards and guidance for managing sustainability impacts²⁶.



Figure 4: Examples of groups involved in global and regional ESG initiatives

In 2021, Italy held the G20 Presidency in 2021 and organized its work under the banner of 'People, Planet and Prosperity'.

It had a very specific focus on the role of all types of investors, including pension funds as part of the Sustainable Finance Working Group. The group is important in the words of the G20 Presidency because: 'mobilizing sustainable finance is essential for global growth and stability and for promoting the transitions towards greener, more resilient and inclusive societies and economies'. The Presidency hosted an important forum for the private sector on the SDGs and ESG in May 2021²⁷. The event reviewed the challenges and developed 10 areas for action for investors like pension funds and investee companies that would be able to better align investment strategies with the SDGs²⁸.

²⁶ <https://impactmanagementplatform.org>

²⁷ The event focussed on four main areas: a): Overcoming informational challenges by improving sustainability reporting; b): Developing consistent approaches to identify, verify and align investments to sustainability goals; c): The role of International Financial Institutions in Supporting the Paris Agreement; and d): Priorities for the G20 Sustainable Finance Roadmap from a Private Sector Perspective.

²⁸ The final Synthesis Report of the Sustainable Finance Working Group is at <https://g20sfwg.org/wp-content/uploads/2021/10/G20-SFWG-Synthesis-Report.pdf> alongside a wealth of useful references and papers on different aspects of the issues from global and regional organisations at www.g20sfwg.org.



There are now almost daily announcements by companies setting targets to reach net zero greenhouse gas emissions.

Such companies will obviously be attractive to investors seeking to improve the alignment of their portfolios to ESG issues. However, there is a huge amount of action still needed, given that the current level of public commitments by companies²⁹ only cover under 20% of global publicly listed companies and hence so far does not represent the extent of even promised change necessary.

²⁹ International Energy Agency.

³⁰ International Energy Agency.

³¹ The ability to take a long-term view is a particularly important advantage for pension funds – but also means it is even more important for them to take into account impacts from climate change which will be increasing in significance over time.

³² <https://www.fsb-tcdf.org/>

³³ 'How public pension and sovereign wealth funds mainstream sustainability: Practices of the frontrunners and a proposed integration framework,' UNCTAD, 2020.

“The global Covid pandemic and economic dislocation that resulted led to a 5% drop in Greenhouse Gas emissions³⁰ This clearly came as a result of an unprecedented global shock, but it is a trajectory that will need to be maintained if global emissions are to fall sufficiently.

This raises the issue of significant transition risks as governments, companies, investors and communities adapt to a cleaner and greener future. However, these transition risks are much smaller than those that will be required as a result of damaging climate change if proactive changes are not made. Major investors like pension funds will be key to providing the financing required to support the required transitions. Investments in green, circular, sustainable energy, energy efficiency and other low-carbon sectors can stimulate the economy, while mitigating climate change to increase community resilience and build forward better in a region heavily affected by water scarcity and fast rising temperatures.

“The changes required present clear challenges, but they also offer huge opportunities for investors who are able to take a proactive and long-term view³¹

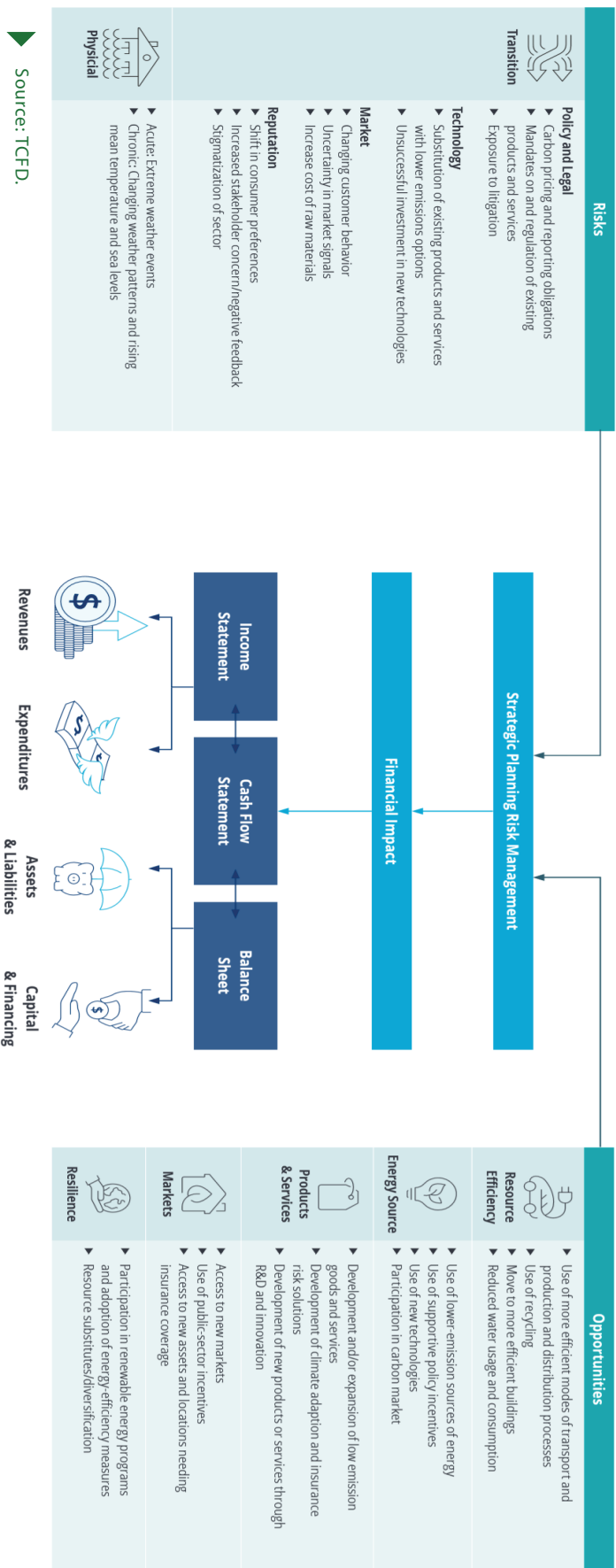
The Task Force on Climate Related Financial Disclosures (TCFD)³² has taken a leading role in creating a framework for climate related disclosures and working with companies to help them meet the new requirements. As set out in Figure 5, there are both important risks and significant opportunities for businesses to recognize and for investors to consider when allocating capital. Currently, the following are among the most widely adopted standards : the Task Force on Climate-related Financial Disclosures (TCFD, climate-related reporting), CDP (climate-related reporting), the International Corporate Governance Network (ICGN, corporate governance-related reporting) and the Global Reporting Initiative (GRI, general sustainability reporting). *“The TCFD is gaining popularity and has the potential to become the industry standard for climate-related risk reporting. The GRI, as a general sustainability reporting standard, is increasingly adopted by pension funds³³”.*

Climate-Related Risks and Opportunities

The Task Force identified several categories of climate-related risks and opportunities. These include potential financial impact to assist investors, and companies consider longer-term strategies and most efficient allocation of capital in light of the potential economic impacts of climate change.

“Climate change presents global markets with risks and opportunities that cannot be ignored, which is why a framework around climate-related disclosures is so important. The Task Force brings that framework to the table, helping investors evaluate the potential risks and rewards of a transition to a lower carbon economy.”

-TCFD Chair, Michael R. Bloomberg June 2017



Source: TCFD.

Figure 5: TCFD Framework

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The importance of the climate challenges facing the world was emphasized by the recent report from the Intergovernmental Panel on Climate Change (IPCC)³⁴.

The environmental aspects of the ESG debate was a central feature of debates leading up to ‘COP 26’ which the UK hosted in partnership with the Italian government as part of their G20 Presidency³⁵. However, as the recent work of the G20 has highlighted, it is important for the broader Social and Governance aspects of ESG to be given full attention as part of the transformation of the whole development model demanded by the 2030 Agenda.

There is a growing body of guidance and initiatives at the global level for pension funds. This is sometimes specific to pension funds and sometimes as part of wider discussions about the role of asset owners³⁶.

Many pension funds, particularly in Europe, are participants in global initiatives such as the UN Principles for Responsible Investment³⁷. Some initiatives such as Accounting for Sustainability provide focused and tangible ESG guidance and support for asset owners and companies as well as a specific focus on pension funds³⁸. These and other organizations often have invaluable Knowledge Hubs – including for example the one curated by the TCFD at <https://www.tcfhub.org/>. Hence, whilst improving knowledge and creating case studies are important recommendations of this report, it is important not to ‘reinvent the wheel’ and to focus on filling regional and country-level knowledge gaps whilst better connecting regional pension funds to the existing global knowledge bank and initiatives where necessary. Some examples of case studies from outside the region are included in Annex C.



Substantial progress has been made in the last two decades towards implementing sustainable financial sector reforms across the Arab region, focusing on financial stability, inclusion and digital transformation.

This progress presents a potential vehicle for promoting sustainable finance and climate finance in the region and can propel the region towards achieving the SDGs and mitigate climate change risks, particularly for unserved and / or underserved populations. It presents a unique opportunity for the region to fully integrate environmental and social factors into their financial institutions’ business models and core strategies.

³⁴ <https://www.ipcc.ch/report/sixth-assessment-report-working-group-i/>

³⁵ The COP 26 goals are to: ‘1. Secure global net zero by mid-century and keep 1.5 degrees within reach; 2. Adapt to protect communities and natural habitats; 3. Mobilise developed country climate finance of at least \$100bn per year by 2020; and 4. Finalise the Paris Rulebook that make the Paris Agreement operational and accelerate action to tackle the climate crisis through collaboration between governments, businesses and civil society’. <https://ukcop26.org/cop26-goals/>

³⁶ Boffo, R., and R. Patalano (2020), “ESG Investing: Practices, Progress and Challenges”, OECD Paris.

³⁷ See <https://www.unpri.org/>

³⁸ See <https://www.accountingforsustainability.org/en/index.html> and their Knowledge Hub which contains pension specific guidance and case studies Knowledge hub ([accountingforsustainability.org](https://www.accountingforsustainability.org)).

In particular, the Arab region is an increasingly important one for pension fund activities, both locally and internationally.

In 2017, the AMF and the World Bank Group (WBG) published a report on Pension Systems in the Arab Region³⁹. This was the result of consultations with Arab countries and sets out potential solutions and reform proposals for pensions. They aim to balance sustainability and affordability on one hand and adequacy on the other but without creating distortions, and whilst ensuring that pensions are delivered in an efficient way in terms of costs, investment returns and labor market impact. The debate has since continued, with some reforms coming to fruition, but much more still to do. Recent debates, for example, have focused on the changing backdrop to reform caused by the COVID-19 crisis, continued low investment returns and the challenges and opportunities offered by FinTech⁴⁰.

However, the importance of SDG and ESG issues and the links between the purposes of pension funds and sustainable development have not typically been a key focus.

The 2018 Annual Report of the Arab Forum for Environment and Development (AFED) focused on the topic of ‘Financing Sustainable Development in Arab Countries’⁴¹ following a series of reports since 2008.

It highlighted the critical need for Arab countries to develop ‘financing strategies and action plans support the implementation of the 2030 [SDG] agenda’ in line with the endorsement of the SDGs in 2015, combined with the provisions of the Paris climate Agreement which followed in the same year. Among a wide range of measures, identifying greater public and private finance flows was highlighted as a critical element. The report touched on a range of options for developing these financial flows but with the potential role of pension funds still to be sketched out in more detail.

In the light of this growing need, and growing debate, UNDP has been attempting to raise the issues in a number of ways. Some efforts are part of a country dialogue.

For example, in October 2020, the UNDP Jordan Country Office in partnership with the Jordan Social Security Investment fund held a series of conversations on these issues. This included people in the international pension space to share and discuss trends in sustainable and responsible investment, risk mitigating strategies and investments in emerging markets. This highlights how individual organizations can take specific action as part of the overall global and regional discussions. It helps to complement the work of the pension funds included in this report who are all showing a commitment to engaging in the issues involved.

Despite these efforts, the AMF and UNDP recognize the need to build a much more significant debate across the Arab region to dive deeper into the role pension funds can play to meet the ESG and SDG challenges.

Any actions will be in the context of the COVID-19 pandemic recovery process which has placed a huge strain on pension funds and pension systems around the world. The broader debate, as kick-started in this report, will focus on the contributions they can make to help achieve the SDGs in the region in the post-pandemic recovery, and what changes are required in the legislative, policy, regulatory, institutional space to achieve this.

³⁹ Arab Monetary Fund; World Bank Group. 2017. Arab Pension Systems : Trends, Challenges and Options for Reforms. World Bank, Washington, DC.

⁴⁰ See for example the agenda for the Arab Pension Conference 2021 Events (fintechrobos.com).

⁴¹ AFED (2018). Financing Sustainable Development in Arab Countries. Annual Report of Arab Forum for Environment and Development, 2018; Saab, N., Sadik, A.K., (Ed.); Beirut, Lebanon. Technical Publications.

IMPACT OF DEMAND , SUPPLY AND SUPPORTING INFRASTRUCTURE FOR PROGRESS ON ESG.

Translating the broad global and regional discussions into assets into which pension funds can invest will come through the following changes in three main channels.

- 1 Demand from investors such as pension funds;
- 2 Supply of investable products from companies and governments
- 3 Supporting market infrastructure data, skills and policies to make ESG implementable.

DEMAND FROM INVESTORS

Demand from investors can be expressed in changes in their long-term investment strategies, through their own commitments to a net zero carbon future; to investing in companies with supply chains that respect ESG standards and SDGs, and to investing in companies with strong, transparent and fair governance⁴²

There has been an extremely rapid increase in demand for ESG supportive assets that has been driven by the pension funds themselves in some countries, but also through national government and regulatory action ^{43,44,45}.

⁴² See for example the Malaysian Securities Commission Code on Corporate Governance (Corporate Governance - REGULATION | Securities Commission Malaysia) and the adoption by the code of the country's largest pension fund the Employees Provident Fund <https://www.kwsp.gov.my/-/epf-signs-the-malaysian-code-for-institutional-investors-1>

⁴³ See for example the European Union's 'Sustainability-related disclosure in the financial services sector' https://ec.europa.eu/info/business-economy-euro/banking-and-finance/sustainable-finance/sustainability-related-disclosure-financial-services-sector_en which was followed by consultation by the financial sector regulators at an EU level (including the European Insurance and Occupational Pensions Authority (EIOPA)). The consultation document can be found at: <https://www.esma.europa.eu/press-news/consultations/joint-esa-consultation-esg-disclosures>

⁴⁴ The Indonesian Financial Services Authority (OJK) launched regulation POJK No.51/POJK.03/2017 on the Application of Sustainable Finance for Financial Service Institutions, Issuers, and Public Companies on July 2017. Among other things this requires financial institutions to have a Sustainable Finance Action Plan See [https://www.ojk.go.id/en/Default.aspx# and Indonesia+OJK+Sustainable+Finance +Regulation_English.pdf \(ifc.org\)](https://www.ojk.go.id/en/Default.aspx# and Indonesia+OJK+Sustainable+Finance +Regulation_English.pdf (ifc.org))



The changes in the Arab region need to be seen in the context of this growing demand for ESG-related investments that could be better aligned with SDGs. If current local recipients of external investments do not adapt to ensure they keep up with the requirements of external investors, demand for companies and assets in the region from external investors may fall.

This creates a risk that national pension funds become backstop lender for assets that have both negative impact for people and planet and features in relation to ESG issues such as the risk of being 'stranded' in the sense that a natural resource that was valuable will no longer be of value if there are newer alternatives.

One source of increased demand is created by government commitments for renewable energy and improved energy efficiency. This is complemented by broader SDG adaption plans and the Nationally Determined Contributions (NDCs) required under the Paris Agreement.

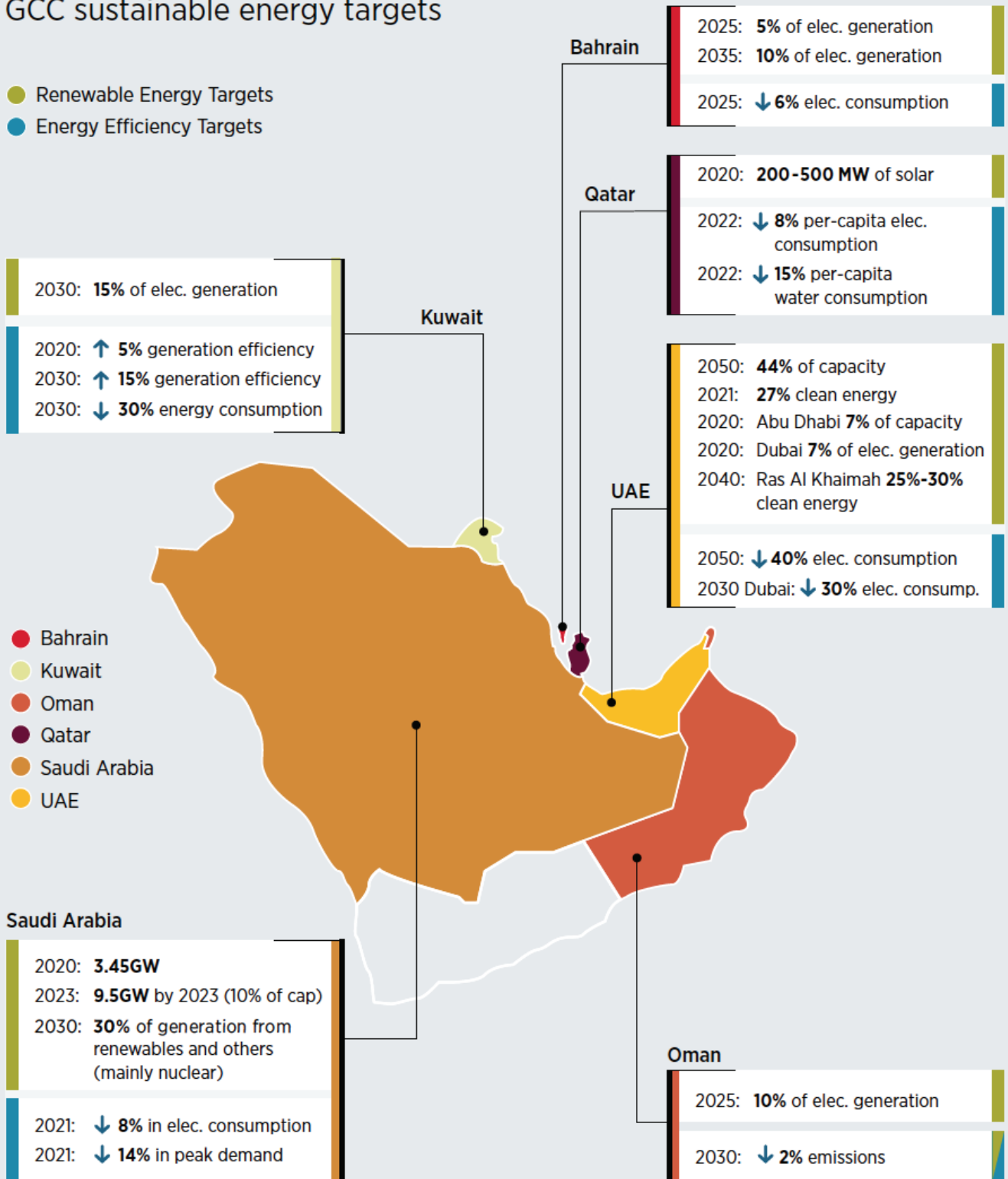
NDCs set out the changes a country is planning to make to meet their commitments under the Paris Agreement⁴⁶. Figure 6 shows some early commitments in the region on the energy efficiency and renewable energy front. Commitments such as these can also be augmented by policy reforms to improve corporate governance, among others so that all of the 'ESG' issues are covered. A linked source of demand are national development plans such as Bahrain's Vision 2030 that seeks to include SDG alignment as part of plans on broader economic development planning.

⁴⁵ Another proactive adopter of ESG integration into the operations of a traditional pension fund is the Thailand Government Pension Fund. For example, in 'Government Pension Fund Thailand Environmental, Social & Governance (ESG) Weight and Score: Asset Valuation Methodology' published by World Bank in 2020 the pension fund set out their ESG journey so far, from the initial commitment to developing increasingly sophisticated tools.

⁴⁶ See for example the February 2021 NDC Synthesis Report from the United Nations Framework Convention on Climate Change at https://unfccc.int/sites/default/files/resource/cma2021_02E.pdf

GCC sustainable energy targets

- Renewable Energy Targets
- Energy Efficiency Targets



Source: IRENA 2019

Figure 6: Renewable energy and energy efficiency targets Gulf States

Another source of demand – or a constraint upon it – are the legal frameworks and regulations for the pension funds themselves.

The picture here can be very mixed with some funds operating under investment constraints and others having a much broader ‘prudent person’ approach to the assets and jurisdictions in which they can invest. As highlighted in the survey results, 5 funds in the region thought their legislation might prevent ESG integration and 2 funds thought there might be a clash with their fiduciary duty. On the other hand, 3 funds thought that changes to legislation would be a big driver for ESG integration in the future, including 2 of 5 currently seeing potential barriers. Hence, this is a dynamic area where governments and regulators can take a proactive role to create change.

For example, in the UK, historic legal judgements about the scope of pension trustee fiduciary duty had for some years introduced a cautious approach to ESG issues even in some pension funds who wanted to properly consider them.

A series of reports identified that there was perhaps excessive caution. But to remove all doubt and indeed to ensure that trustees were properly fulfilling their fiduciary duties to consider material ESG risk, changes were made in law, regulation and Pension Regulator guidance. The latest position has moved to a more positive and proactive statement of duties, as set out for example in the Pension Regulator’s new climate strategy in 2021 and in amendments to the Pensions Act. These make clear that pension funds have a duty to report on ESG duties and to make sure they are considering the potentially significant risks to pension fund members from such factors. In the EU occupational pension funds are covered by the 2016 EU ‘IORPII’ Directive. This now includes a very clear positive statement in Article 19 that: “within the prudent person rule, Member States shall allow IORPs to take into account the potential long-term impact of investment decisions on environmental, social, and governance factors”. These types of legal clarification help to remove doubt for those pension funds wishing to ensure an ESG focus as well as providing a positive push to greater consideration by funds who might not have been planning to consider ESG factors.



Another source of demand that is potentially important among Arab countries is the link between Shariah compliant investment and ESG and potentially the SDGs too.

One of the recommendations of this report is to intensify activity on product development and investment approaches that can achieve both goals at once⁴⁷. Shariah compliant investment is of course an important component in the investment strategies of many pension funds. In some funds, members are able to choose a Shariah compliant investment strategy. This issue is not only found in the Arab countries as it exists for example in Malaysia’s Employees Provident Fund (with over US\$ 200 billion in assets under management). It also exists in the operations of the UK’s National Employment Savings Trust (NEST) - the ‘backstop’ fund as part of the successful reforms to auto-enrolment workers into pension fund. In both funds, members are able to choose a Shariah compliant option if they wish, and the pension funds are required by the respective legislators and the regulators to offer this option.

⁴⁷ However, see Redha Al Ansari and Farah Alanzarouti (2020) ‘ESG and Islamic Finance: An Ethical Bridge Built on Shared Values’ Journal of Islamic Financial Studies 6, No.1 (June-2020) <http://journals.uob.edu.bh> or CFA Institute (2019) ‘Sustainable, Responsible and Impact Investing and Islamic Finance: Similarities and Differences’.

The results of a recent study by the CFA Institute and the UN Principles for Responsible Investment⁴⁸ highlighted a similar range of issues as this report in terms of barriers and drivers to ESG investing.

The key findings are shown in Table 2 below highlighting the range between demand side factors such as increasingly demand from external investors, supply side factors such as the cost of ESG and the essential need for an improved infrastructure to support ESG investing due to gaps in understanding, data quality and data comparability. These issues mirror many of the global issues highlighted by the Private Sector Roundtable hosted by UNDP for the Italian G20 Presidency noted above. The overlaps and areas of difference between ESG and Islamic Finance were well-explained in the CFA UNPRI report and are shown in Table 3.

DRIVERS	BARRIERES
Investor Demand Especially International Investors	Lack Of Standardization Of ESG
Different Esg Issues Drive / Impact Different Sectors	Lack Of Understanding Of ESG
Investment Opportunities	Limited understanding Of How Data Are Analyzed
Asset Flows / Client Demands	Cost Of ESG
Asset Allocation	Lack Of Regulation / Incentives
Regulation	

Table 2: Drivers and barriers to ESG: Findings from Dubai Financial Market

► Source: CFA and PRI (2019).



Thus far, at a regional level, the demand for SDG and ESG investment options has seen much more focus on the ‘E’ side and in particular on climate change given the focus of the Paris Agreement and other global initiatives.

The ‘S’ or social side can be more problematic given the centrality of worker and consumer protections as well as the involvement of global companies and consumer campaigns seeking greater transparency and improved standards in the global supply chain. On the other hand, a number of the pension funds in the region have an explicit ‘Social’ focus in the sense that they aim to invest in national projects that are beneficial to the people. This is a challenging area given that political priorities can sometimes overwhelm investment logic and it highlights the central importance of the final ‘G’ in terms of ‘Governance’. This is important in the governance of potential investee companies but also in the governance of the pension funds themselves⁴⁹.

⁴⁸ CFA and PRI (2019) ‘ESG Integration and Islamic Finance: Complementary Investment Approaches’ for important contributions.

⁴⁹ For example, pension funds could adopt internal rules on the gender balance in their management and boards.

■ Never ■ Rarely (low levels) ■ Sometimes (medium levels) ■ Often (high levels) ■ Always

PRACTICE	ESG INVESTING	ISLAMIC FINANCE	CONVENTIONAL FINANCE
Systematic ESG integration	Medium levels	Low levels	Low levels
Screening	High levels based on client-specific/fund-specific screening policies	100% application based on <i>shariah</i>	Low levels
Company engagement on environmental and social issues	High levels	Low levels	Low levels
Voting	High levels	Low levels	Medium levels
Dividends	No restrictions	100% of dividends are subject to a "purification" process	No restrictions
Interest/ <i>riba</i> earned	No restrictions	No <i>riba</i> permitted	No restrictions
Security lending	High levels with leading practitioners applying rules that ensure they can vote	No security lending permitted, assets must be owned, and <i>riba</i> is prohibited	High levels
Shorting	Low levels	No shorting permitted and assets must be owned	Low levels
Restriction on high leverage	No restrictions	100% application to avoid earning <i>riba</i> directly and indirectly through exposure to high-interest earning companies	No restrictions

Note: Riba refers to interest-based transactions, which are prohibited within Islamic finance.

► Source: CFA and PRI (2019).

Table 3: Comparison of ESG, Islamic and conventional finance investment practices



SUPPLY OF ESG FOCUSED INVESTMENT OPPORTUNITIES REGIONALLY AND GLOBALLY

The supply of investable projects is enhanced where companies and governments develop projects or refocus their activities in ways that are attractive to investors seeking ESG and SDG friendly investments.

There is clearly a strong feedback loop between demand and supply of ESG related projects but globally each side is experiencing a huge rate of growth. The supply of investable projects includes examples given below such as solar power as well as examples from governments who are developing 'green' sovereign bonds as well as similar products from other investors. The outline case for ESG in Private Equity has been set out for some time⁵⁰, but its adoption may have lagged behind its development in other forms of financing. However, the focus on the issue is beginning to change. Numerous market studies are now identifying the importance of integrating a sustainability focus into private equity⁵¹.

Looking at the supply and issuance of different sustainable finance bonds, the International Capital Markets Association (ICMA) estimates that the total amount of sustainable bond issuance was close to US\$ 600 billion by 2020⁵².

This total is made up of bonds that meet one or more of the four main principles, for which the ICMA is the secretariat. These are the: 'Green Bond Principles' (GBP), the 'Social Bond Principles' (SBP), the 'Sustainability Bond Principles' (SBP) and the Sustainability-Linked Bond Principles (SLBP)⁵³.

The picture on supply globally when looking at all assets has seen explosive growth in the past decade, with the Global Sustainable Investing Alliance estimating that total sustainable assets had reached US\$ 35 trillion by 2020⁵⁴.

Growth has been seen across all types of assets and across different types of investment vehicle. For example, the stock of assets in highly liquid and investible exchange traded funds (ETFs) is estimated to have grown from just \$6 billion in 2015 to \$150 billion in 2020 by MSCI⁵⁵. This means that the global supply of ESG related investments is already essentially unlimited for Arab pension funds which are able to invest outside of the region given the huge size of global capital markets. Moreover, the opportunities range across asset classes and investment capabilities and from long-term illiquid investments to more liquid and tradeable investments.

The regional picture on supply highlights prospects for the growth in some ESG aspects, with more challenges in others.

This picture mirrors that highlighted above on the demand side in relation to the balance between the E, S and G aspects.

⁵⁰ See 'Integrating ESG in Private Equity: A Guide for General Partners' UNPRI 2014.

⁵¹ See for example 'The Expanding Case for ESG in Private Equity' Bain and Company, 2021 or 'Developing an ESG framework for private equity', Grant Thornton, 2021.

⁵² <https://www.icmagroup.org/assets/documents/Sustainable-finance/GBP-Infographic-040521.pdf>

⁵³ <https://www.icmagroup.org/sustainable-finance/>

⁵⁴ <http://www.gsi-alliance.org/wp-content/uploads/2021/08/GSIR-20201.pdf>

⁵⁵ <https://www.msci.com/documents/10199/e424982e-ef7e-bf8e-b54f-7f1e0a61deb9>



ENVIRONMENT:

The starting position in a number of oil-exporting Arab states is clearly a fossil fuel orientation to the economy. The discussion on the demand side showed some of the national government efforts to enhance requirements on sustainable energy projects. Figure 7 shows that global supply of solar projects has expanded dramatically in the past 20 years, but it is only in the past few years that the supply of projects in the region has begun to register in global comparisons. In addition, there has been a very large growth in 'green' bonds and green sukuk bringing Islamic Finance and ESG/SDG angles together. Hence, it is clear that there are already projects within the region into which pension funds could potentially invest. However, given the size of some of the pension funds, there will be issues with the total supply and/or the pricing of some of the assets. This is why it is important that pension funds are able to invest outside their home country or the region in addition to the well-known general diversification benefits for their members, in order to have access to a broad enough universe of ESG assets.



SOCIAL:

Social projects are key to the achievement of SDGs in the region. They can range from (public) housing projects to infrastructure projects in slums or underserved communities and areas, which would qualify as a social investment. In addition, there is the potential for a broader range of projects following the 'Social Bond' Principles of the ICMA or similar frameworks. This is an area that has so far been less well-defined and explored than the Environmental and Governance aspects of ESG but one that will hopefully show more growth in the future if pension funds want to really contribute to the achievement of SDGs. It is also an area that needs to be carefully handled. This is to ensure that pension funds invest in the long-term interests of their members rather than have their assets directly towards social projects that could have positive externalities for the economy and hence be worthy of government expenditure but as investments can sometimes reduce the value of pension fund assets and hence the security of member pension benefits.



GOVERNANCE:

There are opportunities to target investee companies prioritizing improved governance for internal resources or to attract investment flows. There are a range of different market providers of data on governance quality as well as providers of third-party services such as 'proxy voting' to help asset owners take decisions on how to vote in resolutions in companies in whom they own assets. There are also many examples of larger pensions funds who have developed in-house capacity to assess the governance of investee companies and then adopt strategies to engage and change behavior and/or to sell assets if the company board is not amenable to positive change.

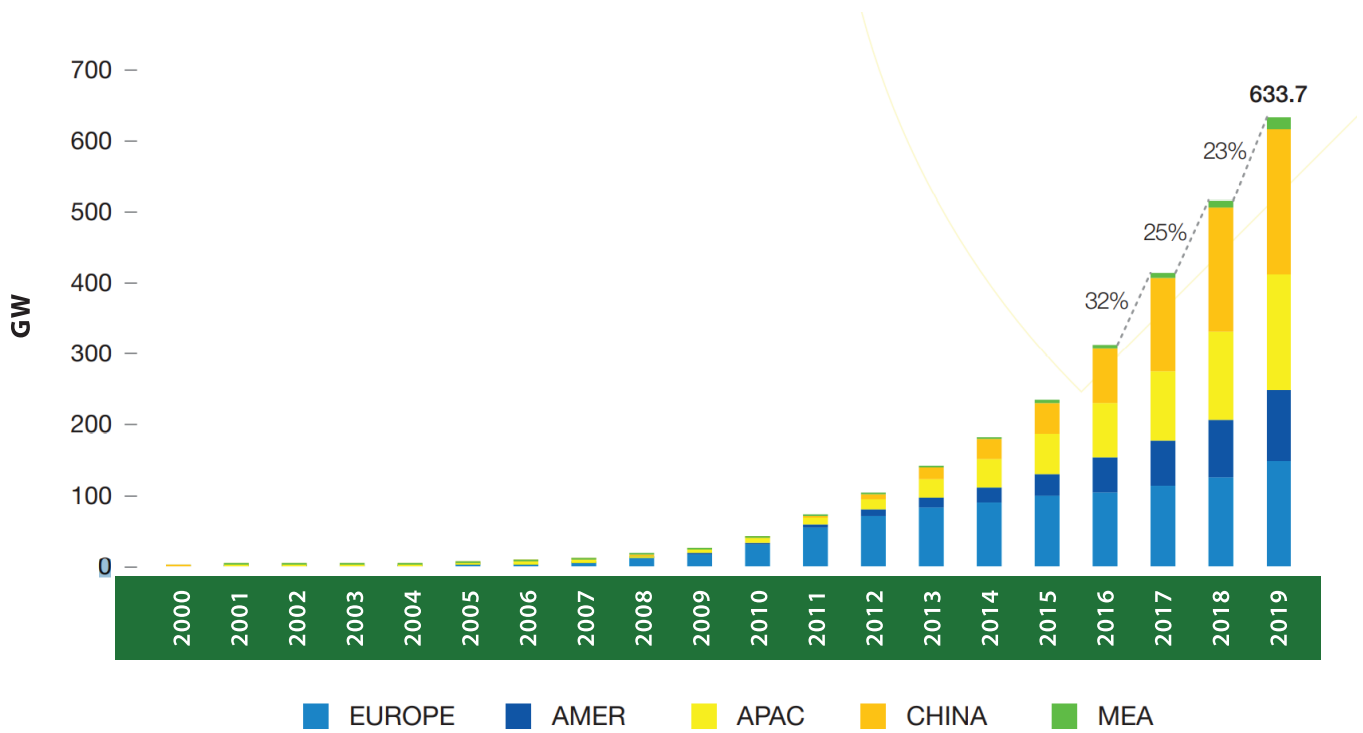


Figure 7: Total Solar PV installed capacity 2000-2019

Source: GMO 2020 Intersolar.

INFRASTRUCTURE TO SUPPORT ESG AND SDGs – MARKETS, DATA AND SKILLS

Supporting market infrastructure, data and skills is needed to ensure that there is sufficient clear and transparent data to evaluate companies and skilled staff to both embed SDGs and ESG issues in headline investment strategies and to evaluate specific investment opportunities.

In addition, a supportive policy framework of legislation and regulations are an integral part of the overall infrastructure to support SDG and ESG alignment for pension funds (and other investors) – as well as affecting the demand-side as highlighted above. Finally, there are the skills required for pension funds to engage actively in social and governance issues in investee companies for example in relation to supply chain management. Some investors undertake this in-house whereas others use external providers⁵⁶.

The skills required may need advisors on actuarial and investment issues as well as in other areas.

This is an area where advisors are developing their own capacity, but pension funds as important clients can increase their expectations. This is important even in technical areas such as the use of Asset-Liability-Matching (ALM) techniques for defined benefit pension plans which need to ensure that ESG issues are incorporated as they impact both the asset and liability side of the pension fund balance sheet over time.

⁵⁶ See for example the August 2021 publication by Alliance Bernstein, a major institutional investor on their Proxy Voting and Governance Policy including the use of third party providers. <https://www.alliancebernstein.com/content/dam/corporate/corporate-e-pdfs/AB-Proxy-Voting-and-Governance-Policy.pdf>

In theory the growth in index funds that have an ESG orientation makes it simple for a pension fund⁵⁷ to integrate ESG issues without needing significant internal resources.

This is certainly an important area of development, and as Figure 8 shows, it is possible to get country-level benchmarking on ESG standards in a global context to help guide investment allocations. The possibility to switch portfolios between countries to enhance ESG integration is a reason why pension funds should have the legal freedom to invest in the country of their choice. It is also an example of the potential threat to the region from a reduction in the supply of capital as global investors also aim to enhance the ESG aspects of their investment strategies.

The situation in the Arab region is developing and there is for example a bespoke regional ESG index created by S&P with Hawkamah⁵⁸. The index has 50 constituents with an average market capitalization of US \$52 million and a total market capitalization of over US \$2.5 billion. It provides exposure to 9 countries in the region in total, although there is a relatively heavy representation for the UAE and Saudi Arabia. As developments are made to implement the recommendations in this report and improve action and data on each of the E, S and G components, it can be expected to have more constituent companies and securities.

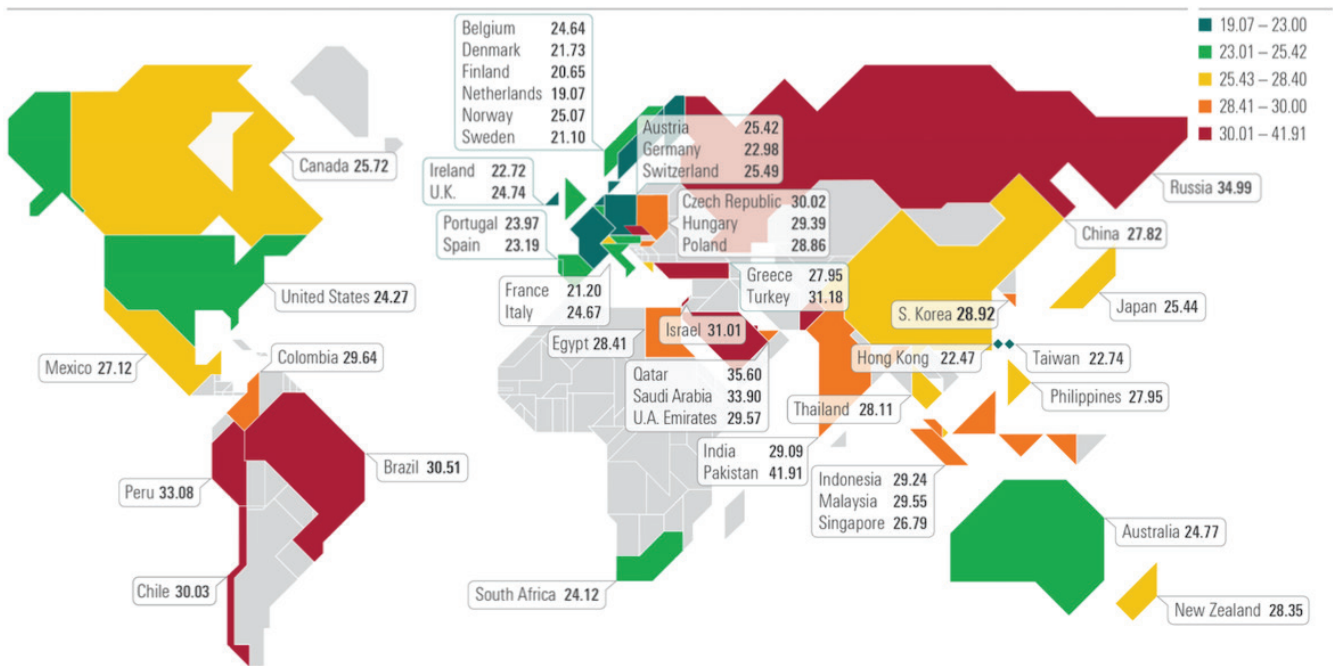


Figure 8: An example of an index comparing countries on an ESG dimension

► Source: Morningstar Direct, Data as of March 31, 2020.

⁵⁷ An index fund allows an investor to invest small amounts each in a large number of assets that have been assembled to reflect a particular asset, country or approach such as ESG. The approach developed as a way to gain exposure to whole market returns given dissatisfaction with the costs and net of fee returns from active management involving stock picking.

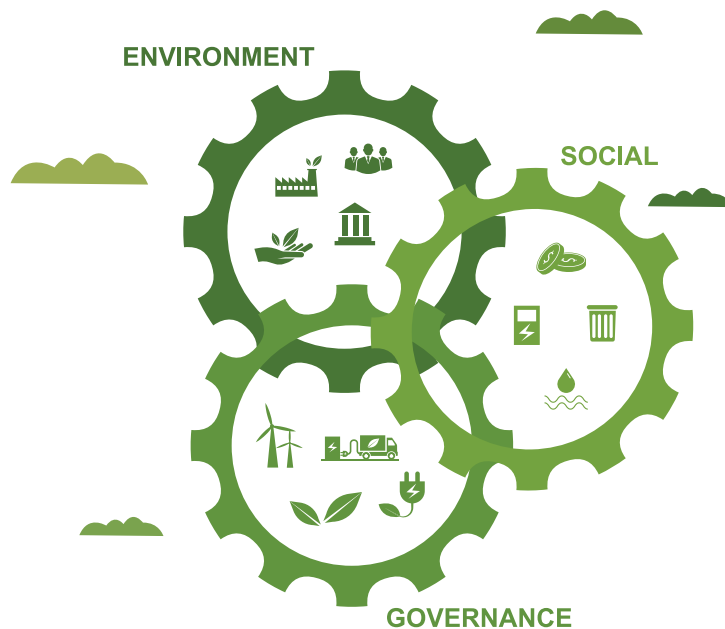
⁵⁸ For the detailed methodology see <https://www.spglobal.com/spdji/en/documents/methodologies/methodology-sp-hawkamah-esg-indices.pdf>

However, a key issue at the moment with the index-based approach to implementing an ESG strategy is the comparability of different ESG indices.

This issue has been highlighted by the world's largest pension fund, and a proactive adopter of diversification and ESG integration, the Japanese Government Pension Investment Fund (GPIF). GPIF is developing its ESG investments in a range of ways. It has identified issues with the different signals from different ESG indices that can cause issues for a pension fund seeking to operationalize a higher allocation to ESG supporting assets. This difference between different ESG index investments is shown in Figure 9. This means that pension funds will need to have a flexible approach until there is a consensus on how to measure ESG factors as part of a pension investment strategy. Getting greater consensus on these issues is a key focus of a number of initiatives including those highlighted under the G20 Sustainable Finance Working Group.

One promising initiative that could help on the infrastructure to support ESG investing in the region is the UN 'Sustainable Stock Exchanges Initiative'.

Figure 10 shows the global growth in the initiative, including the increasing focus in the region (shown in the figure as MENA rather than Arab states). From the figure the pattern can be seen of the region initially not being part of developments 10 to 15 years ago but gaining prominence in the past 5 years. This indicates the scope to expand and develop further. Indeed, Bursa Kuwait just published a new guide to ESG in September 2021 to improve ESG reporting by its listed companies⁵⁹ as an indication of the continued momentum from the region in this area. The activities of Stock Exchanges and Central Banks where they are regulators of financial services can be leveraged to improve disclosure.



⁵⁹ <https://sseinitiative.org/all-news/bursa-kuwait-launches-esg-reporting-guide/>

FTSE and MSCI ESG Score Correlation charts domestic equities (End of March 2020)

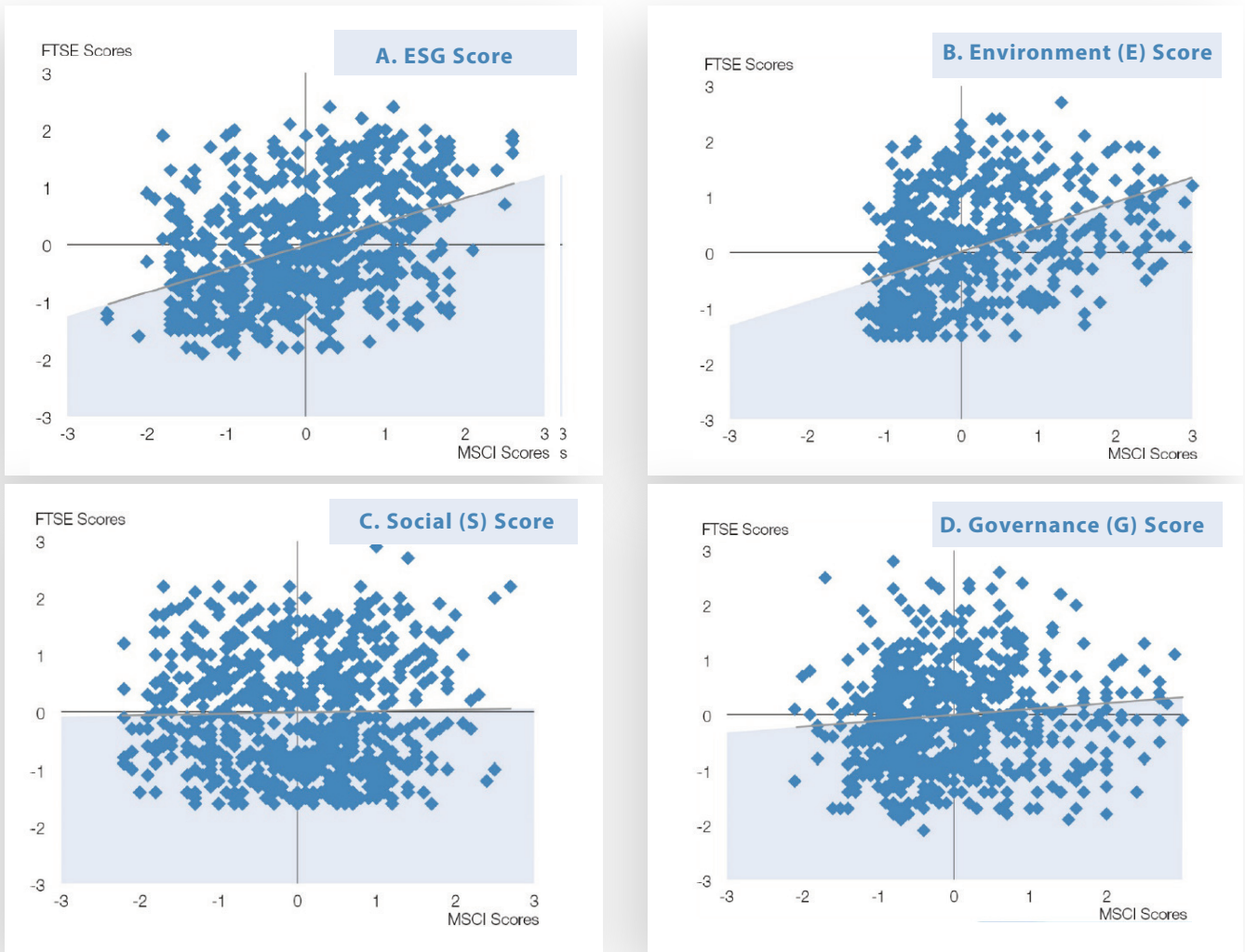


Figure 9: Lack of correlation in ESG indices

Source: GPIF Japan.

Number of exchanges

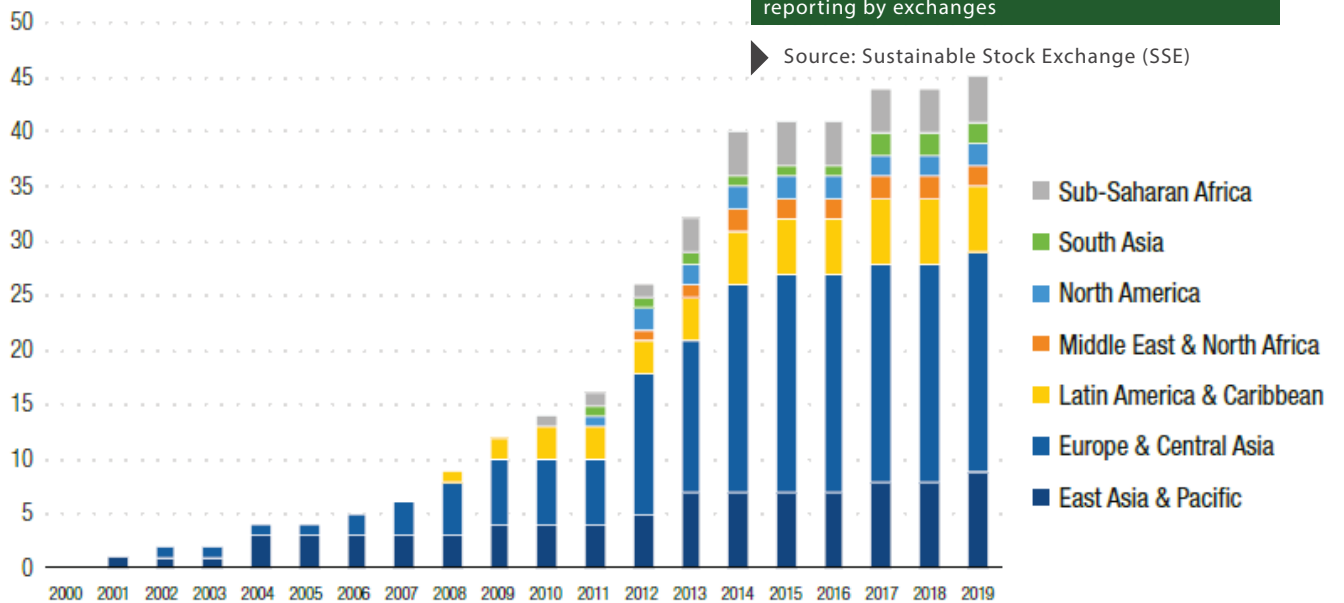


Figure 10: Growth and coverage of sustainability reporting by exchanges

Source: Sustainable Stock Exchange (SSE)



3. KEY FINDINGS FROM THE REGIONAL SURVEY

3. KEY FINDINGS FROM THE REGIONAL SURVEY

METHODOLOGY

PENSION SCHEME SAMPLE

The pension schemes selected for the Survey were identified by reviewing pension funds in the region and then approaching the Ministry of Finance in each country. The participants include some of the largest pension schemes in the region.

The overall pension landscape in the region ranges from a single large fund in a country – often a Social Security fund – to countries with many funds which were a mixture of Social Security and typically occupational pensions. These funds are from public sector (for example related to the employment of civil servants or the military) and private sector and related either to government-created plans for private sector workers or plans set up by large employers. To focus the sample size, it was decided in this first project to focus on larger public sector pension plans, rather than the longer list of (often much smaller) private occupational pension plans. The schemes were approached via the relevant Ministry of Finance.

As part of the engagement process to identify pension funds based on publicly available information it was notable that there was less disclosure of core information compared to work in other regions.

For example, a significant number of funds did not publicly provide information such as Assets Under Management (AUM). However, some pension funds were more in line with international standards for transparency and disclosure. This is an important area for the future of the ESG integration journey for the pension funds themselves as well as investee companies.

Following engagement with Arab Ministries of Finance, 14 pension schemes participated in responding to the questionnaire prepared for this project. Respondents were from the following 10 countries, with 4 providing answers from 2 funds each (marked in bold below):



QUESTIONNAIRE DESIGN

The questionnaire gathered information from participating pension schemes in relation to:

PART 01

Scheme demographics which identified the type of scheme, number of members and assets under management.

PART 02

Philosophy, attitudes and ethics that identified whether the scheme had commenced an ESG integration journey, advice sought, challenges experienced, top drivers for ESG integration, resources that would assist ESG integration, and knowledge of the SDGs.

PART 03

ESG Maturity captured whether formal ESG training had been implemented, the extent ESG has been documented, ESG investment methods used and whether the scheme had collaborated on ESG with peers or other partners.

PART 04

Maturity mapping allowed the schemes to document the practices they had undertaken to integrate ESG, which indicated the ESG maturity of the scheme. These questions were only to be answered by those schemes that had started their ESG integration journey.

MATURITY MAP OVERVIEW

To determine the level of ESG integration currently employed within participating pension schemes, a maturity map was used.

The maturity map has been designed by The Prince of Wales' Accounting for Sustainability project⁶⁰ using the best practice of ESG integration from a range of pension scheme case studies who have progressed to high levels of ESG maturity (see Annex C for some examples). Each pension scheme was assessed across five ESG practice activities; integration, members and sponsors, advisors, stewardship, and climate risk management (Table 4).

It is important to highlight that in an initial survey such as this one, the results from the maturity map are dependent on the self-assessment of the pension funds.

There is some scope for checking key information and filling gaps, but the process cannot be as in-depth as an individual assessment with multiple face-to-face meetings (even if virtual) and a chance to observe and test the processes and approaches at first hand. On the other hand, the benefit of the survey approach is that it allows more schemes to be comparable in a standardized manner. Hence, the survey has the objective of starting the process of kick-starting the discussion on the alignment of schemes with ESG and the SDGs in multiple countries across the region. As highlighted in the recommendations, an important next step for a number of funds would be to have the in-depth assessment that would provide a more detailed action plan to better implement this alignment.

⁶⁰ 'ESG Maturity Map : Example Behaviours for Pension Trustees', Accounting For Sustainability, <https://www.accountingforsustainability.org/content/dam/a4s/corporate/home/KnowledgeHub/Guide-pdf/The%20A4S%20ESG%20Maturity%20Map%20-%20Example%20behaviours%20for%20pension%20trustees.pdf.downloadasset.pdf>

Activity Area	Integration	<ul style="list-style-type: none"> •To what extent has the scheme integrated ESG factors into its investment decision making? •How familiar is the scheme with the United Nations Sustainable Development Goals (UN SDGs)? •To what extent is the achievement of the UN SDGs being targeted through the scheme’s investment philosophy and approach?
	Members and sponsors	<ul style="list-style-type: none"> •How actively is the scheme engaging and understanding its “internal” stakeholders, such as beneficiaries and sponsors, on ESG issues?
	Advisors	<ul style="list-style-type: none"> •How actively is the scheme engaging its external advisors and service providers, such as investment consultants or asset managers, on ESG issues? •To what extent are advisors expected to align with and support the scheme’s ESG strategy?
	Stewardship	<ul style="list-style-type: none"> •What level of active ownership is being undertaken and how? •How are stewardship activities monitored and reported?
	Climate risk management	<ul style="list-style-type: none"> •What level of awareness does the scheme have of the Task Force on Climate-related Financial Disclosures (TCFD)? •To what extent have TCFD recommendations been implemented? •Has climate scenario analysis been undertaken?

Table 4: Focus areas for the ESG assessment

► **Source:** Author based on survey results.

Participating schemes then self-assessed and reported their ESG maturity across the activities using one of four maturity levels from the entry-level knowledge and understanding, to implementation. These are show in Table 5.




Maturity level	Maturity level description	Example evidence of achieving
 <p>1 Knowledge & understanding</p>	<p>The scheme has some knowledge and understanding of the activity area but has not yet made plans or commitments to implement.</p>	<ul style="list-style-type: none"> •The scheme is able to confidently discuss each of the five activity areas. •There has been some (limited) engagement with internal and external stakeholders on ESG issues.
 <p>2 Strategy</p>	<p>The scheme has committed to taking action on the activity areas and documented and signed off the strategy which will be used to address it.</p>	<ul style="list-style-type: none"> •Meets the Knowledge & Understanding maturity level and •Documentation of a plan or strategy on actions to be taken on each activity area.
 <p>3 Engagement</p>	<p>The scheme is actively engaging with stakeholders internally and externally to assess the scheme's ESG risks and opportunities and has created a plan to implement these.</p>	<ul style="list-style-type: none"> •Meets the prior two maturity levels and •Undertakes significant ESG integration dialogues with internal and external stakeholders. •ESG approach is formally documented in investment principles / responsible investment policy.
 <p>4 Implementation</p>	<p>The scheme is actively managing and deeply embedding ESG into its operations and daily interactions.</p>	<ul style="list-style-type: none"> •Meets the prior three maturity levels and •Is implementing its ESG strategy across the five action areas. •Has put in place monitoring frameworks to measure ESG performance. •Proactive engagement with internal and external stakeholders, leading the conversation on ESG issues. •Demonstrates active ownership through AGM attendance.

Table 5: Maturity Map

► Source: Author based on survey results.

DATA ANALYSIS

Data from the Parts 1, 2 and 3 of the questionnaires was collated and analyzed to produce a series of charts that presented the results from the surveys. These figures are presented below after the headline findings in relation to policy and regulatory issues.

The key conclusions from all the figures are presented at the end of the section. A common finding throughout the survey reflect that some pension funds had not actively started their ESG journey, some were in the early days of the process, and some (5) had made more progress. Again, it is important to highlight that the answers are self-assessments by the pension funds. While there was a process to check and clarify answers, this did not involve a detailed on-site review and interviews with the key figures as well as review of internal investment documents that would normally be part of an assessment. Hence the results should be seen as an accurate illustration of the self-assessed position of the funds, but as highlighted in the recommendations a more in-depth assessment would be useful at the individual fund level.

POLICY AND REGULATORY ISSUES

There were a number of questions in the survey on the impact now, and in the future, of the regulatory environment.

This showed a mixed picture about the current impact. However, it also showed the important role that proactive legislative and regulatory changes could have on stimulating greater ESG and SDG alignment. Looking first at current barriers to the greater use of ESG approaches, 5 funds thought their legislation might prevent ESG integration and 2 funds thought there might be a clash with their fiduciary duty. On the other hand, 3 funds thought that changes to legislation would be a big driver for ESG integration in the future – including 2 of 5 currently seeing potential barriers. Hence, this appears to be a dynamic area where governments and regulators can be proactive to instigate change.

Interesting, two of the five funds that identified local regulations as a potential barrier were also ones that had made the most progress on ESG integration among all the surveyed funds.

This means that the local environment does not need to be perfect, or even encouraging, for individual funds and their leaders to take proactive steps to move forward on the ESG integration journey. It can also indicate that in the initial phase of the ESG journey changes can be carried out by the fund, even before being accompanied by a proactive regulation.



There were very few funds that identified any current legislative or regulatory incentives or encouragement for increasing their ESG investments (as opposed to those identifying any barriers).

This is perhaps not surprising given the current level of discussion and development of the issues. It may be the case that the funds interpreted the question narrowly (e.g. in terms of specific provisions for the fund itself, as opposed to including any initiatives as highlighted above to increase demand for example through requirements for ESG disclosures on potential investee companies).

DETAILED FINDINGS

Figure 11 shows that there was a wide range in the state of ESG integration across the 14 funds with some not even starting and the most common answer being that schemes were 'considering how to start'. 5 funds were at a more advanced stage.

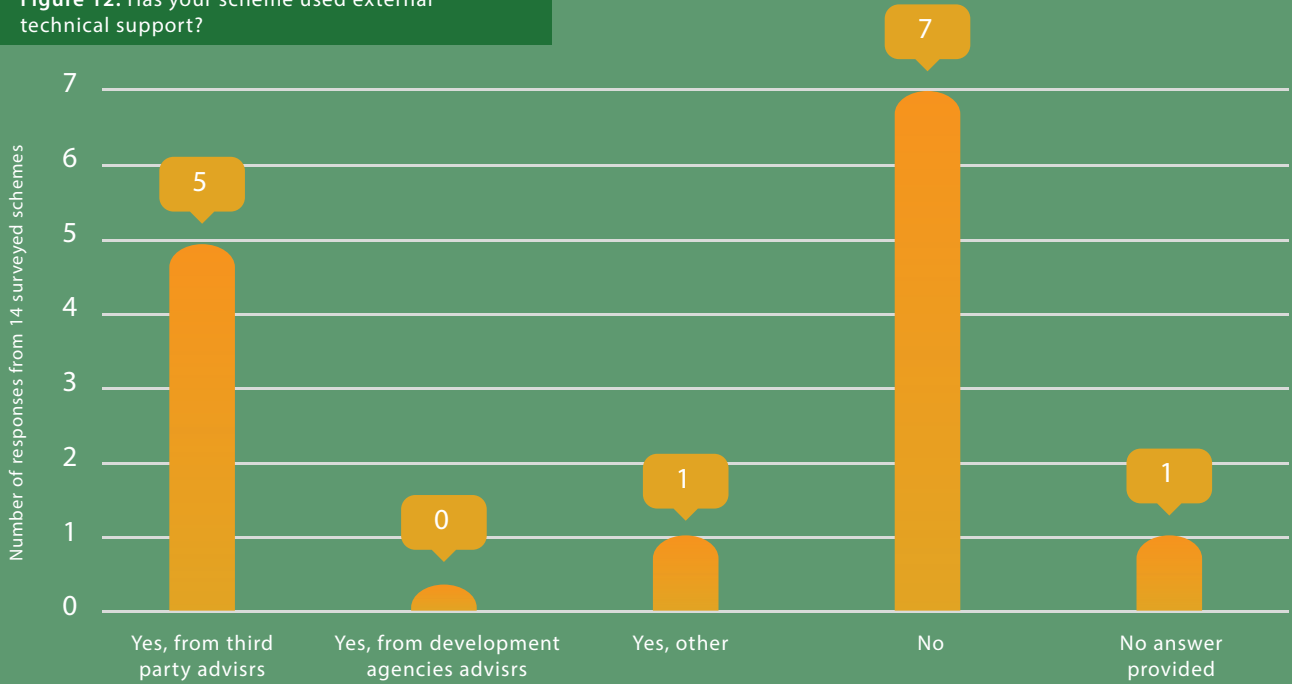
Figure 11: Stage of ESG Integration



► Source: Author based on survey results.

Figure 12 shows that most had not used external support on ESG integration but 6 of the 14 had. This support mainly came from multinational bodies and private sector advisers.

Figure 12: Has your scheme used external technical support?



Source: Author based on survey results.

Figure 13 shows that understanding of the SDGs was much lower than that of ESG. As a result, discussions on the SDGs were far less likely than discussion on ESG although the two areas should be closely linked.

Figure 13: Is your scheme aware of the SDGs or has discussed them?



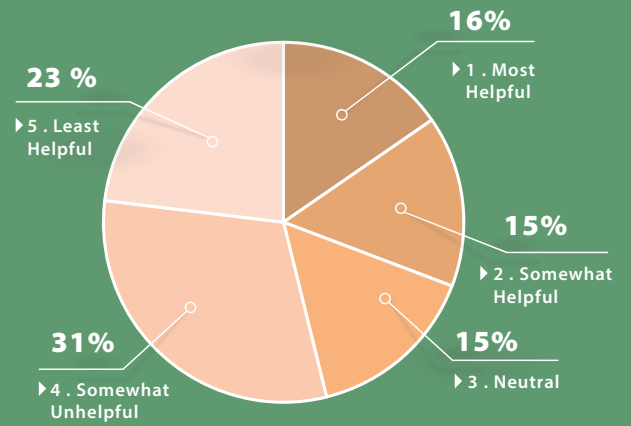
Source: Author based on survey results.



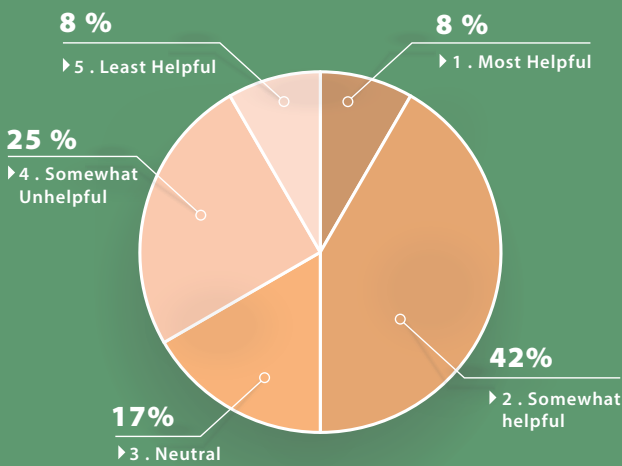
Figure 14 shows the details behind the headline finding that the most useful support for schemes would be the development of peer networks and case studies. Access to advisers who could credibly help on the ESG journey was also identified as helpful. On the other hand, online training and access to templates and example mandates was seen as less helpful.

Figure 14: What would be useful to your scheme to help on the ESG journey?

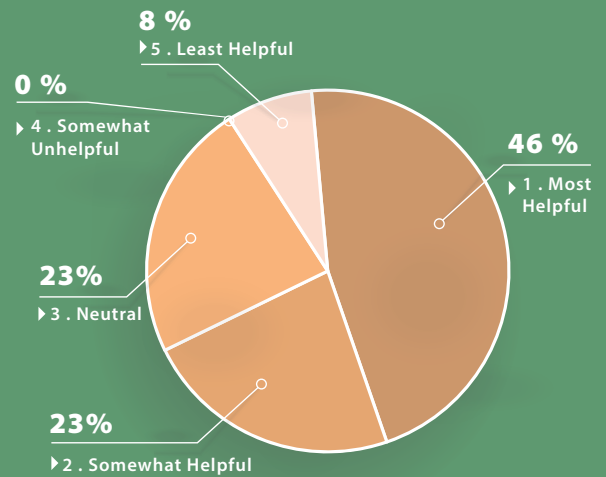
Online training



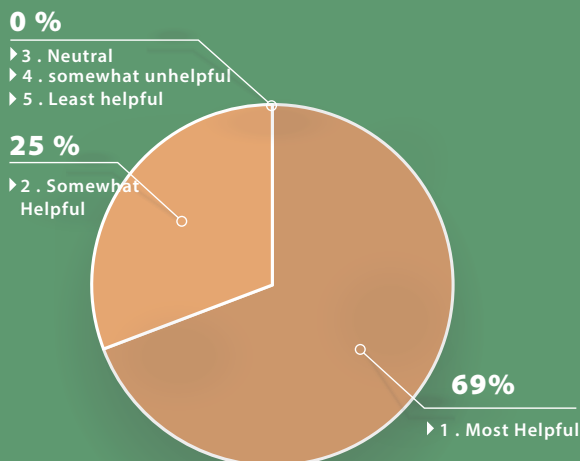
Template documents (E.G. Example mandates)



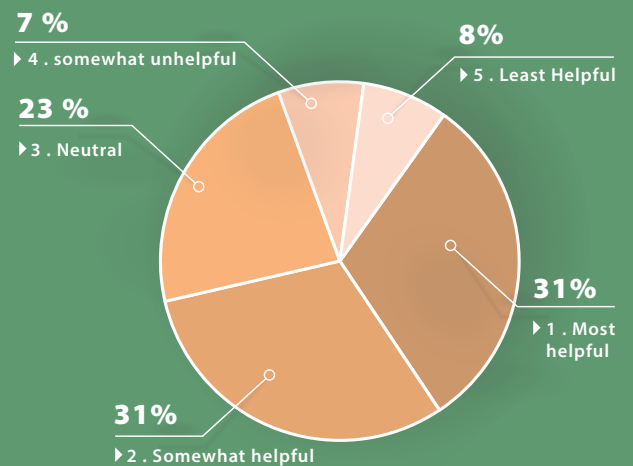
Joining a peer ESG network to share and discuss opportunities



Best practice case studies



Database of recommended third-party ESG advisors



Source: Author based on survey results.



Figure 15 highlights the main challenges for ESG integration.

Lack of reliable ESG data received the highest score (linked to the market infrastructure issue identified above). This was followed by lack of suitable ESG investment products (supply issues) and then belief that ESG is not aligned with local regulations (demand issues). ESG data issues are a global problem on which there has recently been significant activity (e.g. under the Italian G20 Presidency), which could be an important boost for funds in the region.

Figure 15: What could be the top 3 challenges for ESG integration for your scheme?



These answers are reported in percentages due to the question requiring multiple answers.

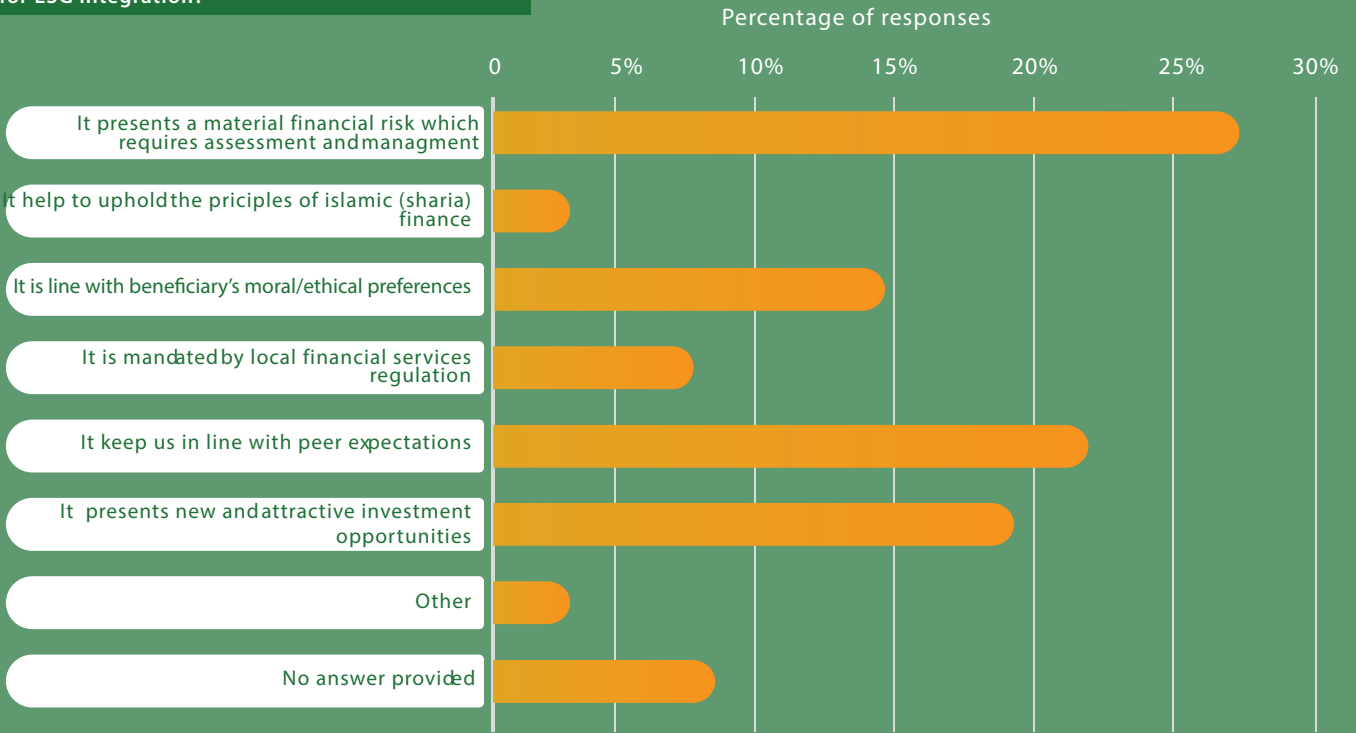
► Source: Author based on survey results.



Figure 16 highlights responses on the top 3 potential drivers of integration.

The most popular answer was that failing to tackle ESG issues presents a material risk to the fund, followed by the desire to keep in line with the expectations of peers and then the positive identification of new and attractive investments.

Figure 16: What could be the top 3 drivers for ESG integration?



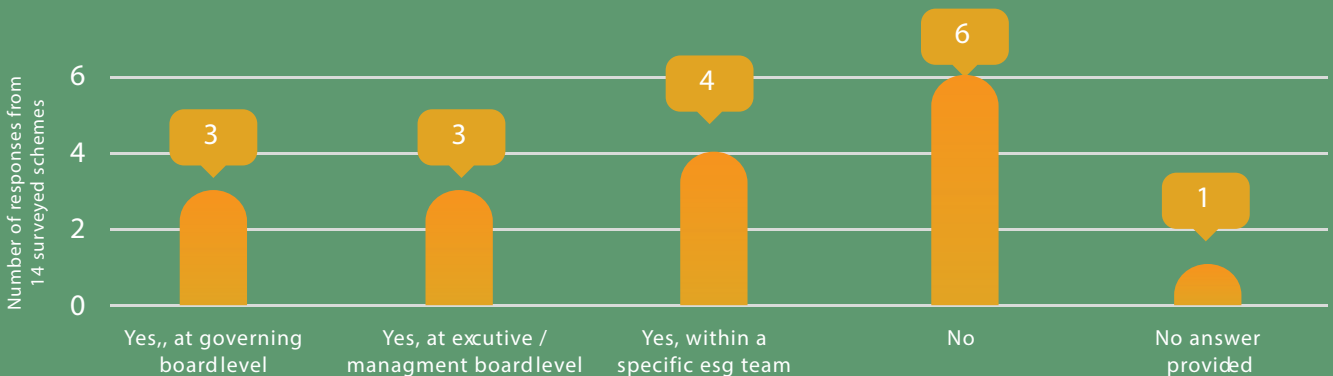
► Source: Author based on survey results.



Figure 17 shows responses to which impacts the schemes prioritize in its investment impact.

This shows quite a range of responses, but with some schemes noting that ESG issues are integrated alongside other outcomes such as 'narrow' financial issues. Some schemes highlight a focus on social equality and justice.

Figure 17: Which ESG impacts does your scheme prioritize in its investment impact?



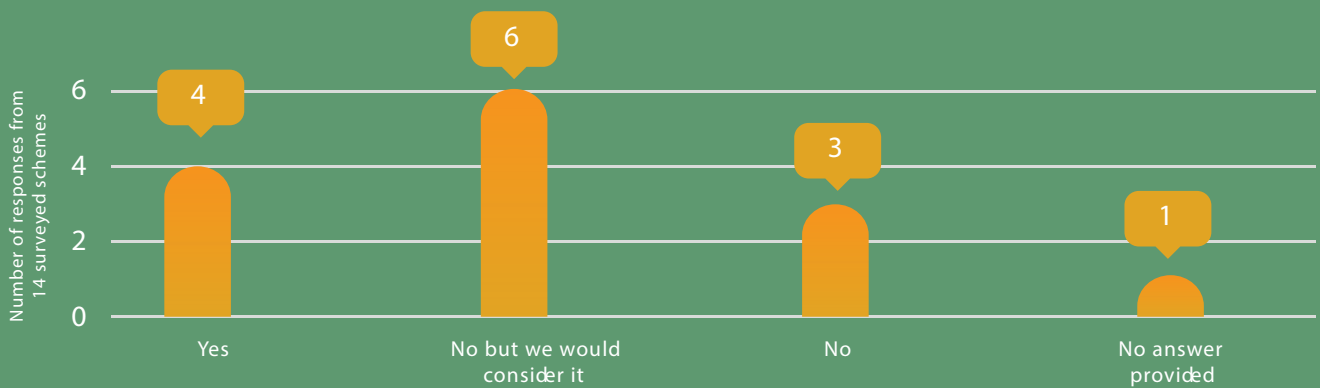
► Source: Author based on survey results.



Figure 18 shows the answers in relation to formal training on ESG.

In many schemes the answer is no which fits the picture in which some funds say they have not started their ESG discussions yet. There is then a mixture between funds with ESG training to the Governing Boards, to the Executive Management or to specific ESG teams. As part of a full ESG journey, regular training programs will be needed.

Figure 18: Has the scheme undertaken formal ESG training?



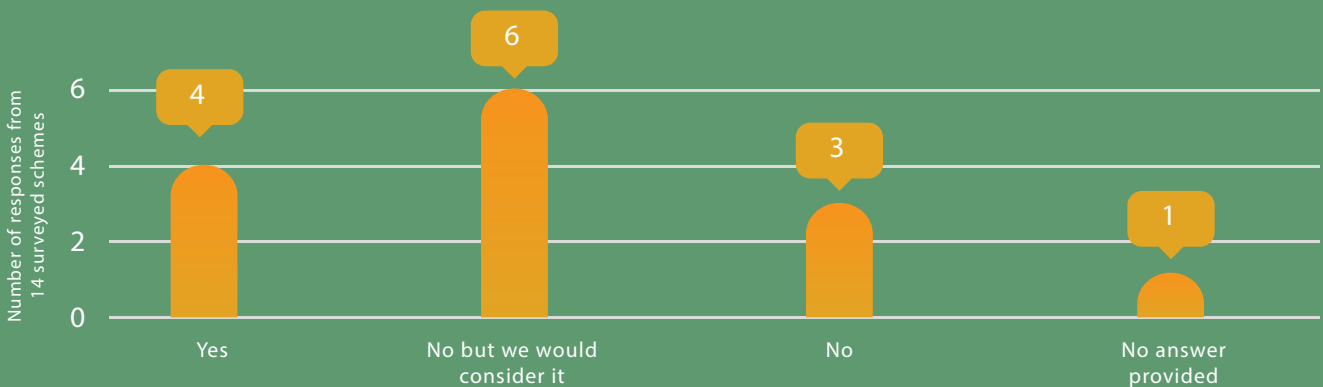
► Source: Author based on survey results.



Figure 19 looks at if schemes have documented ESG integration into the investment process.

Not surprisingly only 4 funds said yes while most funds had not started yet or only just started their ESG integration journey.

Figure 19: Has the scheme documented ESG integration into the investment process?



► Source: Author based on survey results.



Figure 20 then asks how schemes have documented ESG integration into investment process which is obviously only applicable if the scheme answered positively in Figure 19 that they had integrated ESG in their investment process.

The fact that only one fund had put the ESG integration into their (public) mission statement and 4 had included it into internal documents mirrors the general trend of a lack of transparency on ESG, including on pension funds management issues, noted above.

Figure 20: How has the scheme documented ESG integration into the investment process?

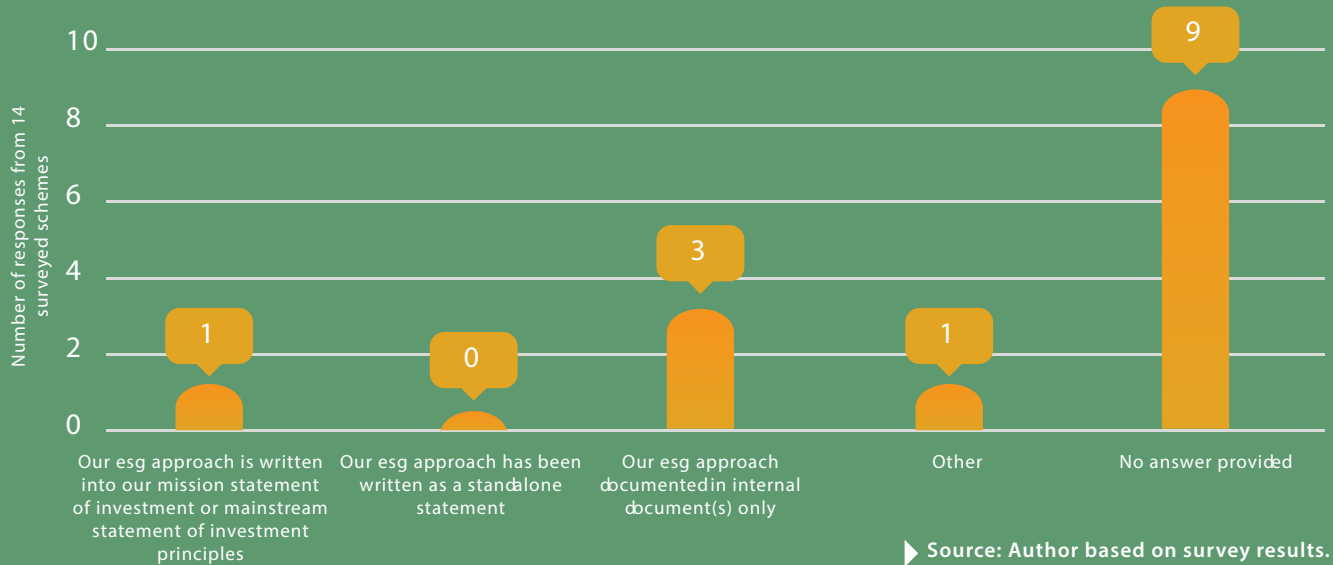


Figure 21 looks at whether global institutional investors have approached the pension fund for ESG insights.

The majority of funds have not been approached which may indicate that both demand and supply are relatively low or at a nascent stage. However, some funds have been approached, indicating that there is some potential for proactive engagements although starting from a low base.

Figure 21: Have global institutional investors approached your fund for ESG insights?

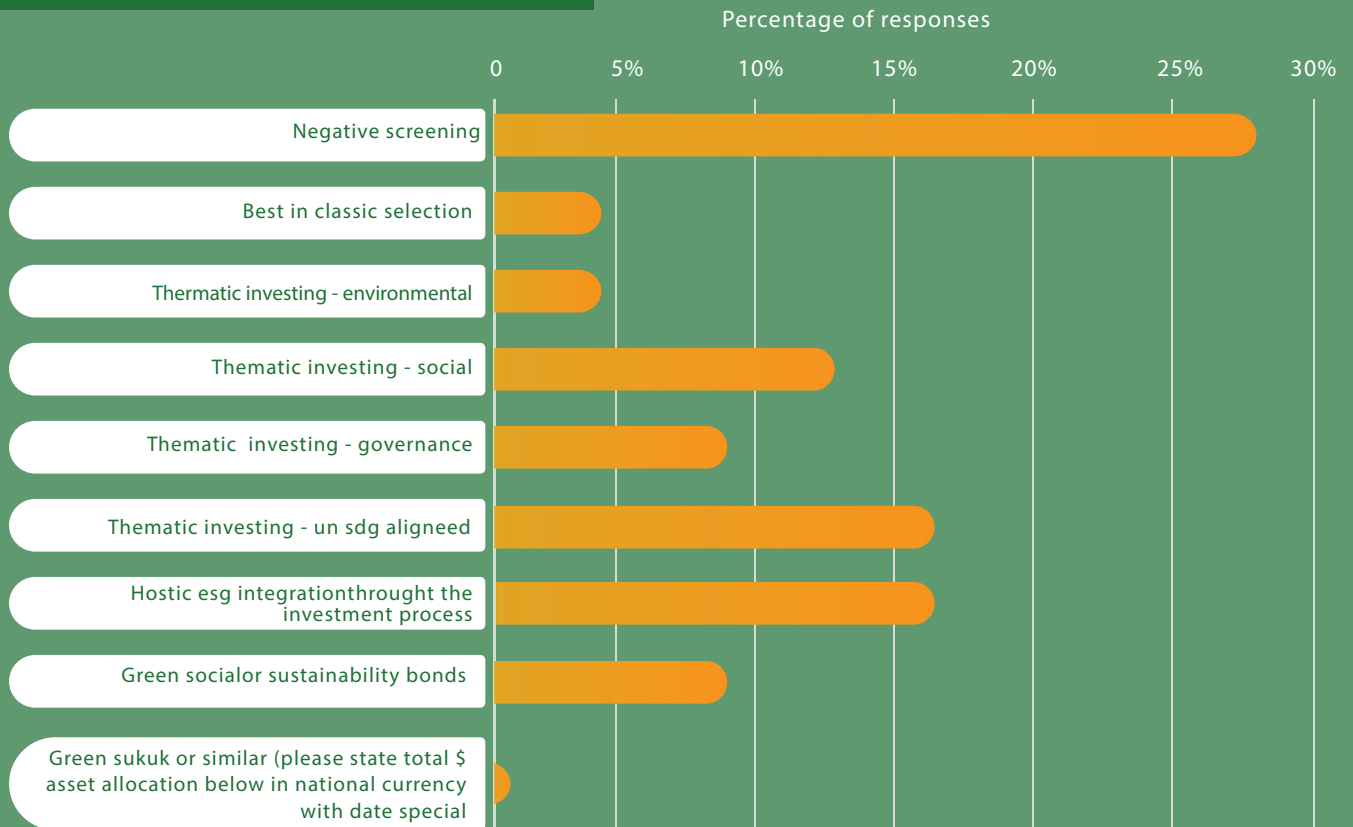




Figure 22 asks about different approaches to ESG integration.

This highlights that the negative screening approach is most common, which would correlate well with some funds that are used to this approach from Shariah compliant investment. Other approaches such as thematic investing, best in class selection and the use of green or social and sustainability bonds all get a few positive answers.

Figure 22: Which approaches to ESG integration is your scheme using (if any)?



► Source: Author based on survey results.



Figure 23 then looks at whether there has been any peer collaboration so far on ESG, which is interesting in the light of the response that such collaboration is rated by many funds as the most useful form of support going forward.

The numbers of yes and no answers are evenly split, showing that many funds are already starting such interactions whereas there is untapped potential for others.

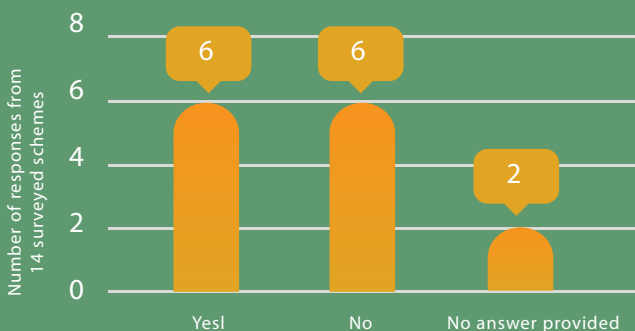
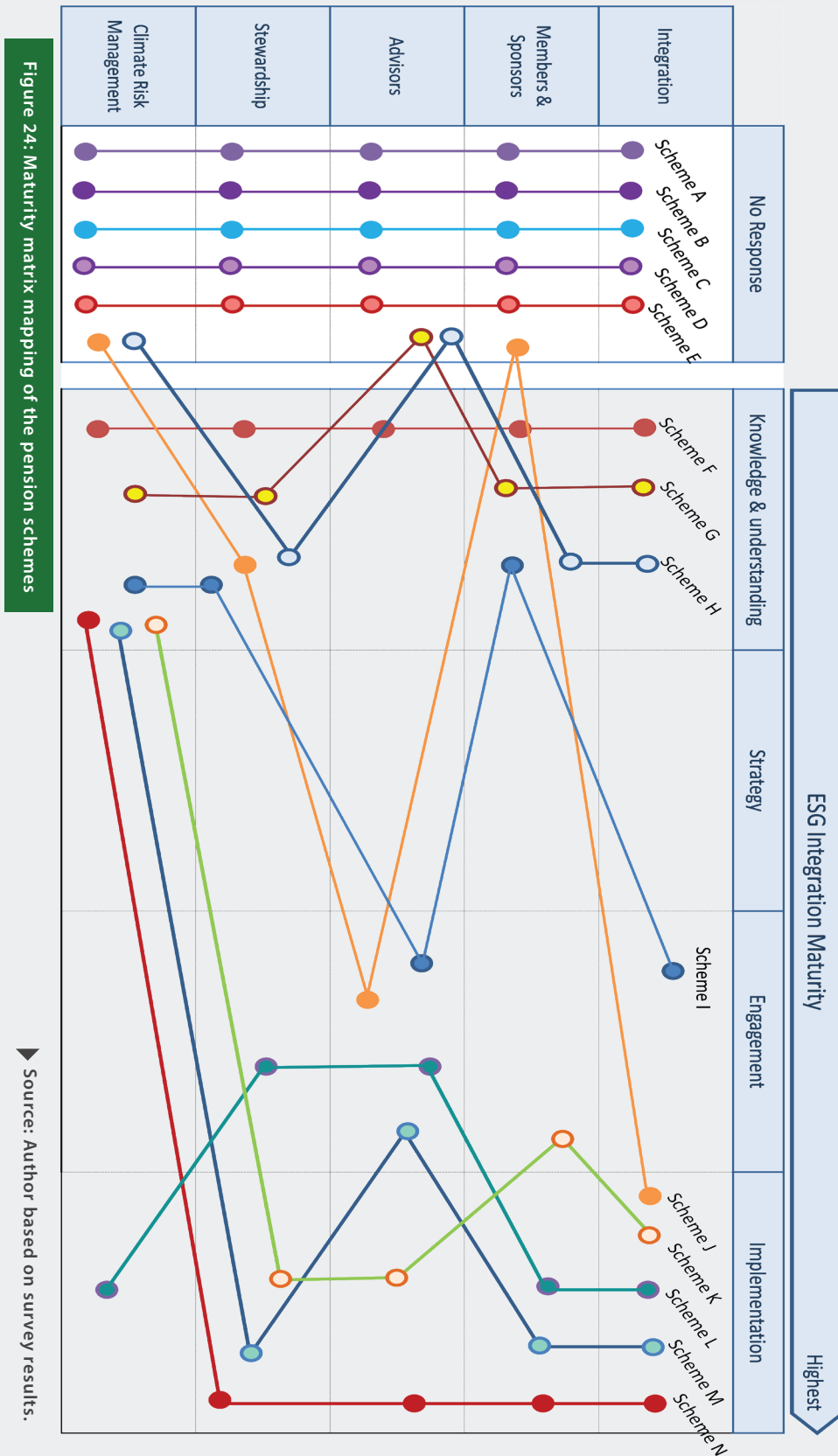


Figure 23: Has your scheme collaborated with any other peers of partners on ESG?

► Source: Author based on survey results.

Part 4 of the questionnaire, the maturity mapping, is plotted on a chart (see Figure 24) to visually demonstrate the level of maturity reported across the five maturity thematic areas.

Five schemes did not answer questions on the maturity mapping area of the questionnaire because they had not started their ESG integration journey. The Figure shows the different categories investigated on the vertical axis and the stage of maturity on the horizontal axis. It then shows for each pension fund where they were rated on each category. As the Figure shows there is quite a wide variation within each fund on the level of maturity on each category – as well as a general tendency for some funds to be more mature on average across each category than others. This Figure summarises the information in the individual Figures to allow a useful overview of the results. It also shows that for 5 of the schemes that engaged they did not provide sufficient answers to be mapped onto the Figure.



SUMMARY OF DETAILED FINDINGS OF THE SURVEY

- 1 The majority of schemes have not integrated, or are at early stages of integrating, ESG into the investment strategy and process.
- 2 Five schemes are reportedly operating at the higher levels of maturity of ESG integration.
- 3 No significant integration of the SDGs into the investment strategy of pension schemes in the region was identified by the pension funds, although 10 of the 14 funds surveyed had 'noted the SDGs but not discussed in detail'. However, there was more active discussion on ESG issues, which will need to be more firmly rooted with the 2030 Agenda principles in the future.
- 4 Of the schemes that had integrated ESG, 'Integration' was consistently the highest scoring maturity theme. 'Climate risk management' is the theme that consistently scores the lowest level of maturity.
- 5 The most valuable tools to support integration that were cited were peer networks and case studies.

THE CURRENT STATE OF ESG INTEGRATION IN THE REGION

Overall, the results from the 14 surveyed pension schemes indicated that five schemes have not started their ESG integration journey, not scoring any levels on the maturity matrix.

Three respondents were in the early maturity stages of ESG integration, and five respondents indicated those that had started or were mature in their practice.

A large variety in ESG integration maturity in the region was found. Survey responses provided evidence that schemes operate at both ends of the ESG maturity spectrum, either being mature or having little to no ESG integration.

Few schemes were observed to score in the middle of the maturity matrix, suggesting that ESG maturity in the region is either relatively high or low/not started. This presents an opportunity for mature schemes to share their experience and best practice with the less mature schemes in the region whilst noting that the results are from a self-assessment and hence they should be tested in depth with a detailed review.

Those schemes that had integrated ESG always scored the highest level of maturity in the 'Integration' maturity theme, suggesting this is the area of maturity that are prioritized as the focus of integration activity.

'Stewardship', 'Members and sponsors' and 'Advisors' had a more varied level of maturity rating but often performed either the same level or a lower maturity rating than 'Integration'.

The majority of pension schemes surveyed scored relatively low on the maturity thematic area of climate risk management, a trend observed even in the most mature schemes.

This suggests there is a large opportunity to educate and integrate climate risks and opportunities. Embedding this risk assessment into schemes in the region is particularly pertinent given many oil generating countries will be impacted by the economic and social repercussions of the global transition to a low-carbon economy in pursuit of achieving the Paris Agreement.

When considering why some schemes were operating at a much higher level of maturity than others, the ESG maturity trend does not appear to be tied to the country of operation of the scheme.

This is evidenced by the large inter-country differences seen within some countries where funds are likely to operate within potentially similar regulatory regimes but have significant different maturity ratings. As the recommendations set out, more detailed and direct assessment for a given pension funds of its ESG status and the key steps that are needed would be a useful part of any next steps.

Schemes reported that the top three drivers for integrating ESG was the need to manage the material financial risk that poor ESG performing investments presented (26% responses), followed by the need to align with peer expectations (21% responses) and to take advantageous investment opportunities (19% responses).

Only 2% of responses identified their ESG integration driver as upholding the principles of Shariah finance, suggesting this is an insignificant driver of ESG adoption in the region – which may be a bit surprising and may reflect the fact that the overlaps between the ESG and Shariah compliant approaches to investment is not a well-known phenomenon.

The most commonly reported investment method used to integrate ESG into investment decision making, was negative screening (29% of responses).

As this is the same method used when investing along Shariah principles, it may be reflective of the comfort these schemes have in using this particular investment method (and add to the sense that the lack of a Shariah driver for ESG integration may be due to the way in which questions were answered by the funds rather than underlying practice in them).

A low level of consideration and integration of the SDGs into pension schemes was identified.

No schemes reported that they were actively supporting the SDGs in their scheme's operations. Hence, one of the recommendations focusses on enhanced activity in this area, which is crucial for the integration of ESG standards rooted in the 2030 Agenda framework and principles. The schemes are partly not familiar with the terminology. The fact that discussion of ESG is more common while being at an initial stage may provide an opportunity in the region to start the ESG integration journey taking in due consideration of the 2030 Agenda, thereby avoiding the risk of narrower and shallower development impact. But in terms of the answers to the survey question specifically on SDGs the reported results were that 10 of 14 funds had 'noted' the SDGs but not held detailed discussions. Box 2 presents an anonymized example of current practice in the region.

Example of ESG integration steps taken by a pension fund in the region:

- Documented a clear and comprehensive ESG investment philosophy that outlined its ESG appetite.
- Outlined clear ESG criteria and expectations of investment managers, in relation to their investment strategies, investment selection & monitoring, stewardship and reporting.
- Created a monitoring framework to assess the decision making and stewardship practices undertaken by their investment managers and consultants.
- Put measures in place to analyse and identify the climate risks in their investment portfolios.
- Introduced practices to engage with and communicate ESG progress with scheme members on a regular basis.
- Engaged external advisers to explore the stewardship and engagement options available.

The pension fund's strategic priorities for deepening ESG focus:

- Calculating the carbon footprints of the underlying holdings in their investment portfolios.
- Modelling investment portfolios and understanding investment risk under different climate change scenarios.
- Increased engagement with investee companies by asking ESG-led questions at AGMs.
- Publicly reporting performance in line with international sustainability and climate standards such as TCFD.

Box 2: Example of current practice from a regional pension fund (anonymized)

THE FUTURE OF DEVELOPING ESG INTEGRATION IN THE REGION

When giving a rating for resources that would be useful for integrating ESG, respondents were clear that relevant case studies and a peer ESG network would be the most helpful.

This approach to raising ESG integration practice in a region is well demonstrated in the UK where a number of networks operated by NGOs bring together trustees and their chairs to collaborate in “safe spaces” to mutually overcome challenges, share advice and build strong inter-industry networks. Conversely online training and template documents did not score highly on their usefulness as tools.

The respondents reported that key challenges they faced to integrating ESG were lack of reliable and comparable ESG data and lack of relevant ESG investment products.

This barrier is a global challenge and not unique to the region. There are significant international efforts underway to improve the situation, which should be helpful for the Arab region.

Survey responses suggested that the belief that ESG was not complimentary with fiduciary duty or had negative financial outcomes such as higher management fees or lower financial returns was not a significant hindrance in the region.

However, the spread of responses across the multiple challenges suggests that ESG integration challenges are likely to be specific to the scheme rather than an overall trend at a regional level.

The fact that the evidence base for the positive impacts with an ESG focus is growing and deepening (as outlined in Box 1 and Annex B) and that a current scheme in the region can identify so many specific actions already taken (as shown in Box 2) presents the compelling case that change is both beneficial and possible. However, additional work will be required to make sure that the ESG integration process is firmly rooted in the 2030 Agenda principles with the support of the adoption of SDG impact standards.



4. CONCLUSIONS AND RECOMMENDATIONS



4. CONCLUSIONS AND RECOMMENDATIONS

This report provides the results of a unique survey of major Arab pension funds and their current level of engagement with SDGs and ESG issues.

It uses a survey and dialogue with the funds to assess their ESG integration into their investment strategy and the way in which they operate. These findings are put into global and regional context, highlighting the importance of owners of capital like pension funds adopting ESG issues as a contribution to achieving the SDGs while being at the same time better rooted in the 2030 Agenda framework and principles.

This report is the result of a joint engagement between the Arab Monetary Fund (AMF) and United Nations Development Program (UNDP) to support Arab countries as part of global and regional efforts to achieve the SDGs through integrating ESG frameworks into pension fund investment decision. The results in the report are based on the 14 funds in 10 countries which participated in the survey, with over USD \$200 billion in assets.



The recommendations are focused on steps that can be taken by governments and regulators, pension funds, global and regional organizations and pension fund advisors to deepen the integration of ESG and the closely linked SDGs into pension funds in the region. The main recommendations are⁶² :

FOR GOVERNMENTS AND REGULATORS TO:

1. Propose a roadmap for companies (and funds) to adopt the recommendations of globally recognized reporting practices⁶¹ as a first step to stimulate the provision of ESG and SDG related data and information for pension funds.
2. Adopt the approach set out in the International Organization of Pension Supervisors (IOPS) 'Supervisory Guidelines on the Integration of ESG Factors in the Investment and Risk Management of Pension Funds'.
3. If needed, revise national legislation and regulations to ensure the pension fund legal remit allows ESG integration as a key part of delivering fiduciary duties to members and also ensures the right mix of support and powers to regulators and ministries to ensure ESG and SDG impact standard adoption.
4. Ensure that national investment regulations applied to the pension funds do not prevent them from investing overseas as this may be conducive for some funds to achieve further progress on ESG alignment⁶².
5. Ensure that ESG integration clearly delivers better reporting of enterprise and investor impacts on people and planet.
6. Develop internal capacity to understand and utilize ESG and SDG impact standards.

FOR THE PENSION FUNDS TO:

1. Develop their internal capacity and access to advice to show how the lack of integration of ESG factors rooted in the 2030 Agenda and SDG impact principles may undermine investment strategies and outcomes and how to ensure ESG factors are embedded into SDGs-conducive strategies, and implemented, monitored and tested accordingly.
2. Commit that the next iteration of their investment strategy will incorporate ESG factors and, progressively, impact standards within the Agenda 2030 principles and framework.
3. Create robust internal impact management systems. Organizations that adopt the ESG and SDG Impact Standards may be in a better position to meet growing sustainability reporting and disclosure requirements.
4. Require advisers to integrate ESG factors into investment strategy or acquisition advice.
5. Ask companies in which the pension fund is invested for ESG disclosures and ensure the funds make these disclosures too (until national legislation requires it as recommended above).
6. Improve transparency and disclosure of ESG issues and SDG impact standards, with clear communications to members on the benefits of the changes and how they support fund performance.
7. Engage actively in new peer networks and conduct ESG and SDG integration readiness assessments.

⁶¹ Examples of global principles and practices are as follows: UN PRI (www.unpri.org), GRI Standards (www.globalreporting.org), the International Integrated Reporting Framework (<https://www.integratedreporting.org/resource-type/technical/>), SASB (<https://www.sasb.org>), the Climate-related Financial Disclosures (TCFD - <https://www.fsb-tcf.org/>), etc.

⁶² Note that the overall policy framework in a country can also be reformed to ensure that the economy as a whole will be aligned to achieve the SDGs and ESG outcomes. This report focuses only on the pension specific aspects.

FOR GLOBAL AND REGIONAL STAKEHOLDERS ⁶⁶ TO:

1. Support the development of a peer network in the region that allows pension schemes to collaborate and share best practice for ESG integration, impact metrics, and to raise the profile of the SDG impact standards in their investment strategies.
2. Support the creation of regionally relevant case studies and guides with clear practical advice.
3. Provide access to qualified advisors able to provide advice to scheme management and Boards on integrating ESG and SDG impact standards into investment, and to governments and regulators on the changes they need to make (as highlighted above) to enhance ESG and SDG focus by funds.
4. Support the development of tools and guidance to monitor advisors so that funds can appraise them on ESG expertise when procuring their advice and monitoring them on an ongoing basis.
5. Support the design and roll out of ESG financial investment products that are also Shariah compliant – working with regulators, pension funds and sustainable stock exchanges.
6. Continue global and regional work harmonizing SDG and ESG data and indices.

FOR PENSION FUND ADVISERS TO:

1. Ensure that their advice to the pension funds is clearly and transparently integrating ESG and SDG impact standards into the core investment process and that they have the tools, data and expertise required to assist the pension funds ⁶⁷.

⁶⁶ The Global and Regional Stakeholders and initiatives are discussed in detail in Section 2 and include UNDP at a global level and the Arab Monetary Fund at a regional level.

⁶⁷ There is no single uniform set of tools to mandate, but advisors should be able to show how they are integrating the latest global and regional best practice on relevant framework and tools – as identified for example in Section 2 and 3 and in the supporting references. Moreover, given the fast-moving pace of expertise and frameworks in this area, advisors will be expected to show how their approach is developing in sophistication and precision over time.

ANNEXES

ANNEX A: FIDUCIARY DUTY

Fiduciary duty is an obligation for pension trustees to manage the assets in the best interest of the beneficiary. There are two key dimensions to fiduciary duty:

- 1. Loyalty** - Fiduciaries must act with integrity and honesty in their beneficiary's interest. Conflicts should be managed impartially. Fiduciaries should not act for their own or other third party's benefit.
- 2. Prudence** - Due skill, care and diligence should be applied, acting as a 'prudent person' would.

The debate about the definition and scope of fiduciary duty has been active in recent years as the UN under the PRI, UNEPFI and other partners have sought its legal clarification in relation to incorporation of ESG in investment decision making.

In particular, attention has focused on whether fiduciary duty is a barrier to ESG incorporation for pension schemes.

Unambiguous mandatory corporate governance consideration and disclosure for a company's impact on communities and the environment exists for directors in a range of countries e.g. under section 172 in the UK Corporate Governance Code⁶⁸. However, no explicit requirements exist for pension trustees to date, which has contributed to ambiguity and open debate on the topic.

The latest UNEPFI / PRI report⁶⁹ states that three main reasons exist to why fiduciary duty within the definition of loyalty and prudence, requires the incorporation of ESG issues:

- 1. ESG incorporation is an investment norm,**
- 2. ESG issues are financially material,**
- 3. Policy and regulatory frameworks are changing to require ESG incorporation.**

⁶⁸ Deloitte, Board briefing on the new Section 172(1) statement, 2019, Online, <https://www2.deloitte.com/content/dam/Deloitte/uk/Documents/audit/deloitte-uk-board-briefing-on-s172-statement.pdf>

In the US, academics have challenged the PRI's assertion⁷⁰.

One of their arguments claim that a fiduciary's sense of ethics in defining ESG may violate the fundamental duty of loyalty. They argue that legally, ESG investing is only permissible in the situation where the fiduciary is exclusively using ESG investing to benefit the beneficiary through improved risk-adjusted return.

This demonstrates that whilst the debate around fiduciary duty and ESG has certainly matured, in some jurisdictions it is not fully resolved.

Meanwhile, from its extensive analysis the UN PRI concludes that modern fiduciary duty is not a blocker for ESG integration and fiduciaries should :

- 1 . Incorporate financially material ESG factors into their investment decision making, consistent with the timeframe of the obligation.**
- 2 . Understand and incorporate into their decision making the sustainability preferences of beneficiaries/clients, regardless of whether these preferences are financially material.**
- 3 . Be active owners, encouraging high standards of ESG performance in the companies or other entities in which they are invested.**
- 4 .Support the stability and resilience of the financial system.**
- 5 . Disclose their investment approach in a clear and understandable manner, including how preferences are incorporated into the scheme's investment approach.**

Recent developments in the UK, have resulted in the Pensions Regulator⁷¹ expecting trustees to now document their policies on their approach to risk and any material financial factors, specifically requiring consideration of climate change.

⁶⁹ UNEPFI, 2019, An updated look at fiduciary duty in the 21st century: incorporation of ESG issues required and increasingly clarified in regulation. <https://www.unepfi.org/news/industries/investment/an-updated-look-at-fiduciary-duty-in-the-21st-century/>

⁷⁰ Schanzenback, M.M. and Sitkoff, R.H., 2020, Reconciling Fiduciary Duty and Social Conscience: The Law and Economics of ESG Investing by a Trustee, Stanford Law Review, 72 (381), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3244665

⁷¹ The Pensions Climate Risk Industry Group, 2020, Aligning your Pension Scheme with the TCFD Recommendations: A Guide for Trustees on Integrating Climate-related Risk Assessment and Management into Decision Making and Reporting, Online, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/877305/aligning-your-pension-scheme-with-the-TCFD-recommendations-consultation-guidance.pdf

ANNEX B: TRADITIONAL VERSUS ESG INVESTING

A growing body of evidence is slowly alleviating historic concerns that ESG investing sacrifices financial return.

Studies are beginning to better understand the corporate financial performance of companies with a strong ESG practice due to availability of data sets that track ESG performance over a longer timescale.

A significant amount of this research is finding a positive correlation between a company's ESG performance and corporate financial performance.

This trend is largely attributed to the better risk management, sustainable business practice and generally well managed nature of these companies. Studies are beginning to better understand the corporate financial performance of companies with a strong ESG practice due to availability of data sets that track ESG performance over a longer timescale.

A review⁷² of more than 1,000 research papers published between 2015 - 2020 that analyses the relationship between ESG and financial performance concluded :

Financial performance due to ESG is more noticeable over longer time scales

ESG integration performs better than negative screening

During social or economic crises, ESG is effective at protecting from downsides

Improved financial performance in corporations with better sustainability practices is attributed to improved risk management and more innovation

Better financial performance was identified for corporates and investors who were anticipating a low carbon future

ESG disclosure alone does not result in enhanced financial performance, broader ESG practice (such as monitoring a firm's ESG performance metrics) was more likely to improve balance sheets.

To understand ESG performance through the COVID-19 pandemic, Morningstar⁷³ analyzed fund performance during 2020 and identified a consistent trend for those with higher ESG ratings/lower ESG risk outperforming their benchmark indices compared with funds with low ESG ratings/higher ESG risk.

A separate study⁷⁴ identified that sustainable funds outperformed traditional funds particularly in the first three quarters of 2020 that were most heavily impacted by the pandemic when energy stocks (particularly fossil fuels) suffered steep losses.

⁷² Whelan, T, Atz, U., Van Holt, T., Clark, C., 2021, ESG and Financial Performance: Uncovering the Relationship by Aggregating Evidence from 1,000 Plus Studies Published between 2015 - 2020, Online, https://www.stern.nyu.edu/sites/default/files/assets/documents/NYU-RAM_ESG-Paper_2021%20Rev_0.pdf

⁷³ Morningstar, 2021a, Did ESG Pay Off For Fund Investors Last Year? Yes and No., Available online, <https://www.morningstar.com/articles/1016714/did-esg-pay-off-for-fund-investors-last-year-yes-and-no>

⁷⁴ Morningstar, 2021b, Sustainable Equity Funds Outperform Traditional Peers in 2020, <https://www.morningstar.com/articles/1017056/sustainable-equity-funds-outperform-traditional-peers-in-2020>

ANNEX C: EXAMPLES OF CASE STUDIES ON ESG INTEGRATION

To demonstrate the use of the maturity map, some example case studies (that are from countries that are not included within the scope of this research) have been presented.

This is to demonstrate the respective levels of maturity of pensions schemes outside the Arab State region and the actions they have taken to achieve these levels. These case studies were developed with the participation of the relevant pension funds with the Accounting for Sustainability Initiative (see : <https://www.accountingforsustainability.org/en/index.html>).



(Retailer: United Kingdom)

Maturity level	Integration
1 Knowledge & understanding	<ul style="list-style-type: none"> Publicly Recognised member of pensions ESG networks. Speaks confidently at conferences and events on their experience of ESG integration.
2 Strategy	<ul style="list-style-type: none"> Clearly documented their stance on ESG integration and the incorporation of climate risk management as part of statement of investment principles and general investment policy.
3 Engagement	<ul style="list-style-type: none"> Proactively engaged scheme members to understand their ESG priorities (using third party agency) in order to shape construct of the DC default fund.
4 Implementation	<ul style="list-style-type: none"> Reflecting member views into DC default fund (in which most members are invested) – working with LGIM to review default fund investment strategy.



(Asset Manager: Global with UK base)

Maturity level	Members And Sponsors
1 Knowledge & understanding	<ul style="list-style-type: none"> Confidently speaks about ESG being in line with fiduciary duty at conferences and in ESG network groups.
2 Strategy	<ul style="list-style-type: none"> Clearly documented Trustee decision to seek out member views and engage them on ESG issues.
3 Engagement	<ul style="list-style-type: none"> Surveyed member views to understand their ESG priorities and analyzed the results by demographic group.
4 Implementation	<ul style="list-style-type: none"> Used generational analysis to engage different groups of members on ESG in different ways (e.g. millennials on climate and female Gen X on gender diversity).



(Asset Manager: Global with UK operations and pension fund)

Maturity level	Climate Risk Management
1 Knowledge & understanding	<ul style="list-style-type: none"> Trustees have documented their belief that climate change is a systemic risk and seeks to manage that risk on behalf of its members.
2 Strategy	<ul style="list-style-type: none"> Adopted a scheme specific climate change risk policy in June 2015.
3 Engagement	<ul style="list-style-type: none"> Trustee Chair was a special adviser to TCFD. The Scheme is a signatory of TCFD.
4 Implementation	<ul style="list-style-type: none"> The Scheme fully discloses in line with TCFD recommendations: Governance, Strategy, Risk Management, Metrics & Targets.

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