UKSIF Response: DWP Call for Evidence- Consideration of social risks and opportunities by occupational pension schemes

UKSIF
UK Sustainable Investment and Finance Association

Introduction

The UK Sustainable Investment and Finance Association (UKSIF) is the membership organisation for those in financial services committed to the growth of sustainable and responsible finance in the UK. We look to promote a more sustainable and inclusive financial system that works for the benefit of the environment and wider society.

UKSIF represents a very diverse range of financial services firms committed to these aims, and our 270+ members include investment managers, pension funds, banks, financial advisers, research providers, NGOs, among others.

We are pleased to have played a prominent role in embedding sustainability in the UK's pensions sector in recent years; for example, we worked closely with policymakers during the passage of the Pensions Scheme Act to ensure schemes consider the Paris Agreement goals when ensuring effective climate change governance and report against the Task Force on Climate-related Financial Disclosures framework. Separate to this, we strongly welcomed the government recently committing to our proposal for a central registry of Statement of Investment Principles (SIPs) to improve scrutiny of pension schemes' ESG policies, and we look forward to helping this operate effectively.

We know there is much more government, industry, regulators and others can do to encourage the pensions sector to more effectively manage sustainability risks and opportunities, and ensure that schemes have policies in place to deal with these risks today. We therefore strongly welcome DWP's call for evidence on the consideration of social risks and opportunities by occupational pension schemes. In our response, UKSIF draws on the views of our deep asset owner membership and network, who we recently consulted in a private roundtable discussion to consider the main areas and themes in the call for evidence. Below are the main conclusions from our roundtable, and other separate discussions with our members.

1. Does your pension scheme, or do schemes you advise, have a policy on financially material social factors? In this policy, are social factors discussed separately to ESG factors in general?

UKSIF's asset owner members have policies on financially material social factors and engage on these areas with companies

Our asset owner members have these policies in place, including in investment policies, and regularly engage on social factors in their stewardship and engagement activity. Generally, social factors will be highlighted in the broad context of ESG factors, due to the extremely close linkages and inter-connections that our members see between the 'E', 'S', and 'G.' For example, we note that a pension scheme's engagement with an investee company on bio-diversity risks will often consider human rights' issues, due to the impact that deforestation activity could have on local communities.

UKSIF and our members believe it is critical for policymakers, regulators, and others to recognise the importance of these links between different ESG factors, and not to treat them distinctly. We therefore welcome DWP's recognition in this call for evidence that social issues should not be treated distinctly, and our members have been increasingly taking these issues into account in light of the Covid-19 pandemic. Our members will not treat these issues separately, due to the enormous overlap we see between ESG factors.

To date, climate change has been, by far, the most high-profile ESG issue in the sector and more widely, due to greater awareness of climate issues and because it presents a real existential crisis for the industry and us all, as well being a greater focus in recent years for policymakers and regulators. Despite this, our members continue to take action to help address material social risks and opportunities in their policies, especially where they have significant implications for companies' long-term value (below are some case studies from UKSIF's members demonstrating some recent actions).

2. Does your scheme, or do schemes you advise, have (a) a stewardship policy and/or (b) a voting policy that specify covering social factors?

Our members have stewardship policies on social factors and regularly engage with companies in this respect

UKSIF's members have stewardship and voting policies covering specific social factors, such as diversity, human capital, supply chain conditions, and human rights' abuses. Many firms in our membership support the Workforce Disclosure Initiative (WDI), which is backed by 50+ investors with more than $7 trillion in assets under management and provides companies with a framework to increase the quality and comprehensiveness of their workforce reporting. It is a good example of where many of our asset owner members are taking action, and we were pleased to see a record number of listed companies, 141, disclose their workforce data in its most recent annual survey. We also saw participating companies disclosing more data than previously, with respondents completing 61% of the survey on average, up from 40% in 2019.

Separate to the WDI, some of our members will adopt an exclusionary investment approach to companies where they have been egregious cases of negative conduct on issues such as corruption, human rights' abuses, and bribery. Also, a number of members are part of collaborative investor initiatives aiming to help tackle social challenges, such as the Investor Forum which has led engagement with the fashion group Boohoo in recent years.

More broadly for this year's AGM season, a large number of investors are focusing on social issues as priority themes to inform their approach to engagement and voting (below are some specific examples). This has been driven in part by the increased prominence in the industry, and society more broadly, on the vital importance of companies having a well-engaged and well-treated workforce, and the role this can play in enhancing companies' value.

3. On which social factors do your scheme's investment and stewardship policies focus? What was the rationale for deciding to focus on these particular social factors? Do you refer to any international standards, such as those relating to human rights or labour rights?

There is a significant variety of social factors that schemes will focus on in their policies

Our members will consider a hugely varied range of social issues in their investment and stewardship policies, which has made prioritising a set number of social factors complex. The range of issues will include the following: workforce conditions, human rights, diversity, modern-day slavery, fair pay, anti-corruption practices, labour rights, health and safety issues, human capital, among a multitude of others.

This diversity of issues, and the tendency for them to be more geographically based, can pose significant complexities for firms in identifying and prioritising social issues to focus on in their stewardship and engagement activity. While government may see a role in providing clarity for the sector in identifying priority social factors in firms' policies and engagement, we strongly believe policymakers should not look to explicitly identify, and determine, those material social factors for schemes in portfolios, as this could ultimately interfere with their fiduciary duties. As owners of capital and with responsibilities to clients, schemes must be able to consider those social issues which they believe will most materially impact financial outcomes and savers' returns.

Schemes should continue to determine those most material social risks and opportunities for their clients. However, there is potentially a role for government in clarifying their expectations on the role they expect schemes to play in addressing social challenges, and we support government continuing to bring in robust regulations to tackle pressing social issues. Policy should ensure that regulations can effectively support action on social, not just environmental and governance issues, and following implementation, are then effectively enforced. To this point, we have concerns over the government's recent delay to gender pay gap enforcement and the publication of organisations' modern day slavery statements, which send a negative signal to UK companies. We want to see greater disclosure within companies on a wide range of diversity issues, including mandatory ethnicity pay gap reporting at companies with 250 or more staff.

Government could usefully reiterate that while they expect investors to engage regularly with companies on social factors, that the sector should not be a direct instrument to implement government's specific social policies. We have concerns that should this expectation be in place and government appear to edge towards directing schemes, then this could hugely conflict with trustees' fiduciary duties to beneficiaries. This concern has been highlighted by government's approach to the review of the UK's listings regime; specifically by diluting the listing standards for premium-listed companies seeking to list in UK market, some of our members see this as a way of policymakers potentially shifting greater responsibility to investors on implementing UK social policy and effecting social change, which we believe should remain government's primary role.

In terms of international standards that schemes refer to in their policies, these include: the Workforce Disclosure Initiative, World Benchmarking Alliance which has a 'social transformation benchmark', the Climate Action 100+ Net-Zero Company Benchmark, which will shortly include 'Just Transition' considerations, the 30% Club guidance, the United Nations Global Compact, KnowTheChain, UN PRI, among others.

4. Which resources have you found useful when seeking to understand and evaluate social factors either for your scheme or a scheme you advise? Do you feel that you have sufficient understanding of how companies perform on social issues?

There are some barriers to effectively evaluate companies' performance on social factors

The standards and resources directly noted above have been invaluable to pension schemes in helping understand and evaluate social factors. Despite this, and our improved understanding of company performance on these issues, there remain a number of challenges for pension schemes.

Firstly, the diversity of KPIs, methodologies and metrics on social factors (in part due to the wide range of social issues themselves), compared to say climate change, is one challenge. Measuring an investee company's record, or progress against, a social issue identified by investors can be complex, even following successful engagement with a company's management and board. For example, scrutinising a global multinational's practices on modern slavery in their supply chains can be difficult, particularly if not picked up by ESG data providers and press reports (the latter issue can be exacerbated in cases where this is not a free press in countries).

Closely related to this is the continued lack of consistent 'S' data, making it difficult for investors to neatly and comprehensively reflect social issues in stewardship and sustainability reports. This is in contrast to how we can measure companies' approach to climate issues, such as analysing their carbon emissions or water use. We remain a long way still from having robust data in this respect from investee companies, in part as data providers report on issues in very different ways. Anecdotally, data provided by ESG data providers can sometimes be very out of date, or not decision-useful for pension schemes. The data shared by different ESG providers can often contrast, and they can provide limited data in some circumstances on areas such as supply chain conditions, impacts on local communities, and contingent workers.

As a result of this, we believe investors will need to work closely with ESG data and service providers (which are among UKSIF's members) to find consensus on methodologies and metrics for 'S' factors, and there could be a supporting role for government here. Government could also encourage investee companies to better disclose social risks and opportunities, while The Pensions Regulator could consider ways to educate, and raise awareness among, trustees on social issues following on from the recently published climate change strategy.

Quantifying social risks in a portfolio remains hard to do, though some of our members have, or are developing, proprietary frameworks to help identify the most financially material issues and secure the right data, and UKSIF will continue to support these efforts. In addition to these industry frameworks, policy and regulatory initiatives could help address the issue of a lack of consistent data, such as the EU's revised Non-Financial Reporting Directive. We should recognise it will take some time for corporate reporting on social issues to improve, and we hope the UK can be a leading voice globally in this area and in developing social standards, which are increasingly being recognised as key drivers of value. Specific actions that the UK could adopt to address some of the challenges on data quantity and quality include: beginning work on a 'social taxonomy' which is now being considered in Europe and encouraging global standard-setters, such as the IFRS Foundation, to consider social factors in time in their initiatives.

5. What approach do you, or the trustees you advise, take to managing the (a) risks and (b) opportunities associated with social factors? Why have you chosen this approach?

See our responses to Questions 1, 2 and 3.

6. If this is delegated to asset managers, how do you ensure and monitor that they manage the risks and opportunities associated with social factors?

Pension schemes regularly engage with managers on social factors, but there are some barriers in place

In terms of the relationship between pension schemes and investment managers, some member firms will have monitoring processes in place with managers to ensure social considerations are reflected in the investment process and engagement.

Throughout the year and during the AGM season, schemes will regularly raise questions on social factors in their conversations with managers and when contentious resolutions are proposed at companies' AGMs; for example to ensure managers reflect clients' voting policies and preferences on social issues. Schemes will work closely with managers to ensure that their approach to stewardship and ESG integration is aligned to their investment objectives and philosophy. Generally, asset owners together with managers will not treat social risks and opportunities separately to ESG factors and there is strong awareness of their close inter-linking.

In advance of the AGM season, asset owners will approach managers on their voting intentions on 'S' issues, with the overall goal being a regular and consistent dialogue. Their expectation will be for managers to report on how social factors are reflected in their investment policies, including outlining this in their annual and bi-annual reports. We recognise that reporting in this area could be strengthened by managers, which lags behind climate reporting by comparison.

As mentioned previously, one barrier to better reporting by managers is the difficulty in agreeing across the investment chain the priority social issues of focus and this can lead to relatively less structured conversations; agreeing priority issues can be complex given many of them are very inter-related in a portfolio.

Another challenge relates to a lack of resources within schemes' sustainability teams, with many historically focusing on climate; the focus on acquiring robust climate data from managers has meant there has been relatively less focus and capacity to consider data on social factors. Separate to these barriers we identify, we do believe asset owners could set clearer expectations of managers in relation to social factors and consider the main, high-level outcomes they are seeking to achieve to help inform this engagement. One issue for managers themselves is that it can be difficult to demonstrate the impact of investor stewardship over a certain period of times, with 'S' manifesting very differently in companies.

UKSIF is very supportive of initiatives to promote more active stewardship on social issues, and would welcome industry efforts to consider a 'Social Action 100+' initiative based on the success of the global initiative Climate Action 100+. This could focus on identifying a common set of social areas of focus and common metrics that are most material for each sector of the economy, providing much-needed clarity for investors, many of which are invested in hundreds of companies in a portfolio all facing very different social issues.

An initiative such as this could have a role in highlighting the less clear-out cases of company failures and malpractice. This is vital as we expect there are a large number of companies performing poorly on issues such as supply chains conditions, but that are given less attention with larger corporates tending to dominate political and media attention (e.g. Boohoo and 'Big Tech').

7. (a) Have the trustees of your scheme, or a scheme you advise, undertaken stewardship (engagement or voting) with an investee company on a social factor in the past 5 years, whether directly or through an asset manager?

Case studies of investor stewardship on social factors

UKSIF's members have undertaken extensive stewardship activity with investee companies on social issues in recent years (both directly and through their investment managers), and below are some examples:

- **CCLA's 'Find It, Fix It, Prevent It' initiative**: This aims to bring the investment management industry together to push for meaningful corporate action to end modern slavery. Investors representing more than £7trn in AUM support the initiative, alongside a coalition of investor bodies, academics and NGOs. Separately, CCLA runs a mental health engagement programme which encourages companies to protect their employees' mental health.
- **Global investor group engagement on mining sector's treatment of indigenous communities:** In October last year, a group of 64 investors including the Church of England Pensions Board, managing $10.2trn in AUM, wrote to the boards of mining companies operating in Australia to seek assurances on their approach to managing relations with indigenous communities. This came in the wake of Rio Tinto's destruction of the ancient Juukan Gorge rockshelters.
- **Investor coalition on modern-day slavery:** A number of UKSIF's members are part of an investor coalition co-ordinated by Rathbones, which targets FTSE350 companies identified as being non-compliant with meeting the Modern Day Slavery Act's requirement of having a modern day slavery statement. In 2020, twenty companies had become compliant as a result of the engagement, representing a success rate of 90%.
- **Good Work Coalition:** A number of our members are also part of the Good Work Coalition, which brings together institutional investors to collaboratively engage on workforce issues, including the Living Wage, diversity and inclusion and insecure working practices. The Coalition calls upon FTSE350 companies to adopt the UK Living Wage.
- **First Sentiers Investors work in Asia-Pacific:** First Sentier Investors has been building an alliance of investors in the Asia-Pacific region to work together to influence the way companies report under Australia's 2018 Modern Slavery Act by setting out clear expectations. This project is based on 'Find It, Fix It, Prevent It.'
- **Brunel Pension Partnership work to support indigenous communities in U.S:** Brunel invested in a clean energy project which engages with the local communities on the Moapa River Indian Reservation in Nevada, United States. Brunel's manager partnered with the tribal community and committed to employ their rich talent pool for building and operating the solar and storage plants. The project also sourced materials from the community and sought their knowledge to maintain critical habitat during construction.
- **Investor coalition on treatment of workers in UAE:** Last year, CCLA, co-ordinated a coalition of 39 investors with over $3trn in AUM to pressure over 50 international companies operating in the Gulf region over the treatment of migrant workers. The coalition requested companies in high-risk sectors such as hospitality, construction, and oil and gas, to perform best practice due diligence on labour outsourcing and commit to reimbursing recruitment fees paid by workers.
- **Railpen workforce priority engagement and voting activity:** Railpen is focusing on "The Worth of the Workforce" as a priority engagement and voting theme for 2021-2024. This has included the following activities: targeted engagement with the largest direct portfolio holdings where there are concerns about workforce treatment; leading engagement on more portfolio companies as part of the WDI and other collective engagements; producing research on the nature of UK workforce disclosure alongside the CIPD and the PLSA; and including more stringent lines in the 2021/22 Voting Policy outlining expectations of corporate treatment of the workforce.
- **Railpen work on 'Responsible Technology':** Another of Railpen's priority themes for 2021-2024 is focusing on issues around 'Big Tech', including governance and human rights

concerns. Railpen will be continuing to engage as part of Royal London Asset Management's Cybersecurity coalition, has recently joined the Candriam collective initiative on facial recognition technology, and is also focusing on the use of AI and technology in workforce recruitment and surveillance in its direct engagements with its largest technology and communications holdings.
- **Scottish Widows engagement priorities:** Scottish Widows engages directly with companies on the United Nations Global Compact (UNGC) violations list, which includes human and labour rights, allowing companies three years to take corrective action and come off this list, before divestment is considered. Separately, Scottish Widows have regular meetings with their core managers to understand their ESG integration, engagement and voting activities around 'S' factors; for example, Covid-19 related migrant workers issues in the Middle East and in Asia, workforce practices by large U.S based retail businesses, and ethnic, racial and gender diversity issues in holding companies, with a focus on material holdings.

We expect the new Stewardship Code, and its focus on outcomes-focused reporting, should help the sector provide greater clarity to government going forward on its engagement with companies on social factors.

(b) If yes, please provide details including why you felt this was necessary, what was done and the impact of your intervention.

Details directly above.

(c) If no, then please provide details including what disincentives and barriers you faced in undertaking stewardship activities (engagement or voting) with an investee company?

Separate to the barriers already highlighted in our response, such as data availability and investee companies' disclosures and the challenges posed by the diversity of social issues encountered by members in their engagement, we note other disincentives our members face in undertaking stewardship. Many of these barriers were highlighted in the recent report published by the Treasury's Asset Management Taskforce Stewardship Working Group, which was convened by the Economic Secretary, John Glen, to consider recommendations to enhance UK leadership on stewardship. These barriers included the following:

- The need to better integrate stewardship in the relationship with investment managers: A number of challenges remain here, including incentivising the relationship in a way that promotes a more long-term perspectives in managers' investment mandates with clients and improving the information flow between managers and asset owners.
- Stewardship across different asset classes: Another barrier relates to stewardship in different asset classes, and improving how stewardship can work in practice in a broad range of asset classes, including fixed income.
- Issues with requisitioned resolutions at listed companies: The use of requisitioned resolutions in UK listed companies, requiring companies to take actions or respond to concerns of a group of shareholders where this is not directly addressed through normal resolutions, has generally been limited in recent years due to resources and costs involved in this process. Requisitioned resolutions could be more proactively used by investors to help escalate concerns with companies including on social issues.
- Lack of understanding on stewardship among schemes: Some pension scheme trustees have historically lacked an understanding of stewardship, including its benefits, and the proposed council of UK pension schemes, which UKSIF is supportive of, could help promote better standards among schemes.
- The role of investment consultants in promoting stewardship: Pension schemes, particularly smaller schemes, rely heavily on investment consultants for knowledge and training, and consultants could provide more active support to schemes in raising the standard of their engagement activity. We hope DWP will take note of this in its ongoing consultation on oversight of investment consultants.

8. What opportunities are there for trustees to invest, directly or indirectly, in companies solving social issues in developing or emerging markets? How attractive are these investments?

N/A

Further information

For more information on our response, please contact Oscar Warwick Thompson, Senior Policy Manager, on: o.warwickthompson@uksif.org.