Department for Work & Pensions

Consideration of social risks and opportunities by occupational pension schemes

A Call for Evidence

March 2021

Ministerial foreword

Over the past decade, the ideas of responsible investment and sustainable finance have gained prominence. The majority of people involved in the investment sector will understand these terms and, thanks to action taken by this Government, pension trustees should be aware of the significance of environmental, social and governance (ESG) factors to pensions. I have taken steps to clarify the law on pension scheme trustees' duties in respect of ESG, to ensure that trustees understand what is expected of them and that members' pensions are protected.

However, in practice, action on ESG has tended to focus on climate change. This has been central to my work as Minister for Pensions and Financial Inclusion, as it has for global policymakers focused on the financial sector. Climate change is the most urgent risk facing our society and economy and we need to act now. But climate change itself is only one part of the "E" of "ESG". The law requires trustees to take account of financially material environmental, social and governance considerations. Trustees are also required to have policies on engagement and the extent to which they take into account non-financial matters such as members' views on ethical and quality of life issues. We also have a more comprehensive UK Stewardship Code that recognises the role that institutional investors play in society.

It has never been my intention that climate change should be trustees' sole ESG consideration - not least because action on climate change is often linked to action on wider social factors. Equally, poor governance in a company may contribute to poor performance on environmental and social considerations. Whilst we have an understanding of what good governance entails, as set out in the Corporate Governance Code, I am concerned that social factors are not well understood.

Many pension scheme trustees' policies in relation to social factors are high level and unilluminating. There is a concern that trustees are ill-equipped to deal with financially material social factors in their investments. How well do they, and those acting on their behalf, understand what is happening in the supply chains? How exposed are they to the risks posed by action on these issues? And what are they doing in response?

In February 2021, I wrote to forty of the largest schemes seeking information about their ESG policies and their stewardship policies and practices. I found performance to be mixed. I am therefore launching this Call for Evidence to seek views on trustees' approach to social factors and to understand whether Government needs to do anything to ensure trustees are better able to meet their legal obligations. I encourage respondents to share their views openly and make pensions fit for 21st century challenges.

Guy Opperman MP
Minister for Pensions and Financial Inclusion

Introduction

This Call for Evidence seeks views on the effectiveness of occupational pension scheme trustees' current policies and practices in relation to social factors. It seeks to assess how trustees of these schemes understand "social" factors and how they seek to integrate considerations of financially material social factors into their investment and stewardship activities.

About this call for evidence

Who this call for evidence is aimed at

- pension scheme trustees and representative bodies
- pension scheme advisers and representative bodies
- civil society organisations
- pension scheme members and beneficiaries
- any other interested stakeholders

Purpose of the call for evidence

This Call for Evidence is seeking views on whether occupational pension scheme trustees' policies and practices on Social factors are sufficiently robust and what the government could do to ensure that trustees are able to meet their legal obligations in this respect.

This call for evidence is an information gathering exercise. It may or may not lead to proposed changes in policy. Any changes in policy would be subject to public consultation.

Scope of call for evidence

This Call for Evidence applies to Great Britain. Occupational pensions are a devolved matter for Northern Ireland.

Duration of the call for evidence

The Call for Evidence period begins on 24th March 2021 and runs until 16th June 2021. Please ensure your response reaches us by that date as any replies received later may not be taken into account.

How to respond to this call for evidence

Please send your written responses to:

Emma Walmsley - Email: pensions.governance@dwp.gov.uk

When responding, please state whether you are responding as an individual or representing the views of an organisation.

Government response

We will publish the findings of this call for evidence on the GOV.UK website.

How we consult

Feedback on the call for evidence process

We value your feedback on how well we consult or seek evidence. If you have any comments on the process of this call for evidence (as opposed to comments about the issues which are the subject of the call for evidence), please address them to:

DWP Consultation Co-ordinator
4th Floor, Caxton House, Tothill Street, London, SW1H 9NA

Email: caxtonhouse.legislation@dwp.gov.uk

Freedom of information

The information you send us may need to be passed to colleagues within the Department for Work and Pensions (DWP), published in a summary of responses received and referred to in the published call for evidence report.

All information contained in your response, including personal information, may be subject to publication or disclosure if requested under the Freedom of Information Act 2000. By providing personal information for the purposes of this call for evidence, it is understood that you consent to its disclosure and publication. If this is not the case, you should limit any personal information provided, or remove it completely. If you want the information in your response to this call for evidence to be kept confidential, you should explain why as part of your response, although we cannot guarantee to do this.

To find out more about the general principles of Freedom of Information and how it is applied within DWP, please contact the Central Freedom of Information team: freedom-of-information-request@dwp.gov.uk.

The Central Freedom of Information team cannot advise on a specific call for evidence exercises, only on Freedom of Information issues. Read more information about The Freedom of Information Act.

Chapter 1: Trustees' legal duties

Requirement to have a policy on financially material social factors

1. Most occupational pension schemes with 100+ members must prepare a Statement of Investment Principles (SIP). In addition, subject to a number of exceptions, a default SIP must be prepared by trustees of schemes with 2+ members offering money purchase benefits and a default arrangement.
2. In 2018, the Government made changes to the legislation governing SIPs, with the majority of changes coming into force on 1 October 2019 and the remainder on 1 October 2020[1]. The legislation requires that SIPs include trustees' policies in relation to financially material considerations including environmental, social and governance (ESG) factors[2]. It also requires trustees of schemes offering money purchase benefits (broadly, DC and hybrid schemes) to prepare and publish an implementation statement reporting on how, and the extent to which, the SIP has been followed during the year[3]. This requirement was extended to DB schemes in legislation the following year, but only in respect of voting and engagement matters.[4]
3. The impact of this legislation is that more than 99 per cent of occupational pension scheme savers are in schemes required to have, and to report on, the implementation of, a policy on financially material social factors[5].

Requirement to have a policy on non-financial matters

4. The 2018 changes to legislation also require trustees to set out "the extent (if at all) to which non-financial matters are taken into account in the selection, retention and realisation of investments". "Non-financial matters" are defined as:

   the views of the members and beneficiaries including (but not limited to) their ethical views and their views in relation to social and environmental impact

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[1] The Pension Protection Fund (Pensionable Service) and Occupational Pension Schemes (Investment and Disclosure) (Amendment and Modification) Regulations 2018 (S.I. 2018/ 988)
[2] The Occupational Pension Schemes (Investment) Regulations 2005 (S.I. 2005/3378), regulation 2(3)(b)(vi).
[3] The Occupational and Personal Pension Schemes (Disclosure of Information) Regulations 2013 (S.I. 2013/2734), regulation 29A(2A)(b) and Schedule 3, paragraph 30(f).
[4] The Occupational Pension Schemes (Investment and Disclosure) (Amendment) Regulations 2019 (S.I. 2019.982) regulation 3.
[5] Estimate by The Pensions Regulator (excludes Small Self-Administered Schemes and Executive Pension Plans where the members are themselves trustees or the directors of a corporate trustee)

> and present and future quality of life of the members and beneficiaries of the trust scheme.[6]

5. This means that trustees of occupational schemes required to have a SIP must set out their policy on the extent to which, if at all, they take into account non-financial matters, which may include wider considerations relevant to members' and beneficiaries' views on non-financially material social factors. In contrast to financially material social factors, trustees are not required to take account of these non-financial matters when making investment decisions.

Engagement and voting

6. Trustees are also required to set out in their SIP their policy on voting and engagement in respect of their investments[7]. This includes how they monitor, and engage with, their asset managers about these issues.

The Law Commission's reviews

7. The 2018 changes to the law were made in light of recommendations by the Law Commission in respect of trustees' fiduciary duties and ESG factors. The Law Commission published a substantial review of the law in 2014[8] and set out its view that "the law is confusing and inaccessible".[9]

8. The Law Commission re-visited its recommendations in a review in 2017 in respect of pension schemes and social impact investing[10]. It found that the confusion it had highlighted in its 2014 report persisted. However, this later review was narrower overall, as it looked at pension schemes and social impact investing. The Law Commission acknowledged that there are various interpretations of what is meant by "social impact investing" and worked from the following:

   > "social impact"…involves investment which incorporates some non-financial element into the decision making, alongside a desire for good risk-adjusted returns.[11]

9. In this call for evidence, we will be specific when we refer to social impact investment, which we see as a specific sub-set of assets/investment. This is not the focus of this call for evidence, which is solely concerned with social factors as risks and opportunities that may affect all assets, in line with the legal

[6] The Occupational Pension Schemes (Investment) Regulations 2005 (S.I. 2005/3378), regulation 2(4).
[7] Ibid, regulation 2(3)(c) and (d).
[8] https://www.lawcom.gov.uk/project/fiduciary-duties-of-investment-intermediaries/
[9] Ibid, Chapter 7, paragraph 7.35
[10] https://www.lawcom.gov.uk/project/pension-funds-and-social-investment/
[11] Ibid, Chapter 2, paragraph 2.32

requirements set out above for schemes to have a policy on financially material ESG considerations.

The UK Stewardship Code

10. In 2020, a new and more extensive UK Stewardship Code was published. It defines stewardship as:

> the responsible allocation, management and oversight of capital to create long-term value for clients and beneficiaries leading to sustainable benefits for the economy, the environment and society.

11. Signatories to the Code are expected to consider corporate governance, environmental and social issues when applying the Code's Principles. Furthermore, Principle 7 requires signatories to:

> systematically integrate stewardship and investment, including material environmental, social and governance issues, and climate change, to fulfil their responsibilities.

12. Pension scheme trustees are not required to sign the Stewardship Code, although TPR guidance encourages trustees to sign up[12]. However, it may be helpful for trustees to be familiar with the Code's Principles, as these seek to embed key aspects of stewardship for asset owners, like pension scheme trustees, as well as asset managers.

Financial and non-financial factors

13. As set out above, the Law Commission recommended that the law on trustees' duties in respect of ESG factors be clarified. This recommendation was followed by the Government in 2018. However, although the law is now clearer, the reality of ESG factors is such that they do not neatly divide between "financial" and "non-financial".

14. Some factors may be financially material considerations in relation to certain investments at certain times, whilst at other times they are not financially material. For example, this may be the case when regulatory reform in respect of a certain business practice appears more or less likely to happen. And, in some cases, trustees may make an investment or stewardship decision on the grounds of financial factors or non-financial factors. For example, in its guidance for trustees, the Law Commission states:

> Withdrawing from tobacco because the risk of litigation makes it a bad long-term investment is based on a financial factor. Withdrawing from tobacco

[12] The Pensions Regulator. Investment guidance for Defined Benefit Schemes (page 22), and A guide to investment governance to be read alongside our DC code of practice (page 23).

because it is wrong to be associated with a product which kills people is based on a non-financial factor.[13]

15. Overall, trustees will need to decide, taking advice where necessary, how social factors are taken into account in their investment strategies.

Questions

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?**

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?**

[13] Para. 1.24, http://www.lawcom.gov.uk/app/uploads/2015/03/lc350_fiduciary_duties_guidance.pdf

Chapter 2: Social factors and financial materiality

What are social factors?

1. Consideration of ESG factors has been dominated by climate change, which poses far-reaching global physical and transition risks for investors. Social factors have been given considerably less attention, which is concerning because pension schemes whose trustees do not consider other financially material ESG factors will risk seeing reduced returns in the future.
2. Social factors are wide-ranging and will mean different things to different people. Nevertheless, trustees need to consider which of these factors are financially material. Some of the social factors investors may wish to consider are shown below. These factors may involve financially material risks *or* opportunities to the pension scheme:

Area	Social factors / themes
Practices within a company and its supply chain	• Health and safety in supply chains • Workforce conditions • Remuneration practices • Modern slavery • Employee engagement; diversity and inclusion
Company products and selling practices	• Product quality and safety, including public health. • Selling practices and product labelling • Customer privacy and data security (Digital rights) • Consumer protection
Companies in the Community	• Management of human rights and treatment of indigenous peoples • Community engagement • Impact on local businesses • Use of local workforces

3. There are also investors who invest along ethical lines,[14] based on moral, religious or values-based viewpoints. In doing so, they may be willing to accept a lower return on the basis that they do not wish to profit from certain types of companies or activities. Many schemes will offer an ethical fund as a self-select option for members.

Social factors and risk management

[14] For example, schemes may offer funds that avoid companies which test cosmetic products on animals, sell or produce tobacco, or provide gambling games. See NEST's ethical fund.

4. Whilst social factors are often linked to wider public issues like health, most investors do not seek to take on the role of governments in seeking to fix the issues – and the Government does not expect trustees to do this. Nevertheless, if social factors are not managed, they could pose financial risks to pension scheme investments, or cause trustees to miss important investment opportunities.
5. Importantly, ESG factors are often interconnected. The transition to a lower-carbon economy entails a number of social considerations, including the impact on communities reliant on certain industries and whether new green jobs will include fair working conditions. Social factors can also be linked to governance. The corporate governance practices of companies, for example, may involve considerations like board diversity and high or low pay. Understanding these interactions can help trustees manage social factors.
6. Evidence suggests the financial sector often takes a reactive approach to social factors like human rights, only responding once the abuses have already occurred, as opposed to proactively engaging to strengthen companies' due diligence and reporting on salient human rights issues.[15] Taking a proactive approach towards social factors could help trustees manage financial risks and other risk factors, including reputational damage and litigation costs.

Resources for identifying and assessing social factors

These resources provide data and information about social factors, which can be used by scheme trustees and advisers to take account of social factors:

Principles for Responsible Investment**:** Encourages investors to use responsible investment to enhance returns and better manage risks. It sets out six principles, which can be used by trustees to take social factors into account. It also provides a number of resources on social issues, including human rights and labour standards, employee relations, and conflict zones.

Business and Human Rights Resource Centre: This digital platform stores news and allegations relating to the human rights impacts of over 10,000 companies. It also features a company dashboard, which provides financial information and scores from civil society benchmarks to assess whether companies are respecting human rights.

Workforce Disclosure Initiative (WDI): Aims to improve corporate transparency and accountability on workforce issues, provide companies and investors with comprehensive and comparable data and help increase the provision of good jobs worldwide. The WDI investor coalition is made up of 52 institutions, with $6.5 tn (£4.6tn) in assets under management. Through its annual survey and engagement programme, the coalition generates new data on workforce practices, which

[15] ShareAction, "Point of No Returns: Part II Human Rights", (2020) https://shareaction.org/wp-content/uploads/2020/05/ShareAction-Human-Rights-Report-2020-Final.pdf

signatories integrate into their investment analysis, as well as practical insights on how to address salient workforce issues including supply chains and wages.

Sustainability Accounting Standards Board Materiality Map: Identifies sustainability issues that are likely to affect the financial condition or operating performance of companies within an industry sector.

Children's Rights and Business Atlas**:** The atlas is an online risk assessment tool that enables businesses to identify, prioritise and manage the potential for direct or indirect infringement of children's rights across 198 countries and 10 industries. This tool can serve as an entry point for including informed children's rights examinations into all due-diligence frameworks. This tool allows business to highlight which areas are of specific concern in their areas of operation and industrial sector, to encourage them to find ways to address these issues.

Human Rights and Business Country Guides**:** A series of 20 guides addressing business impacts on human rights in local contexts. They have been informed by local NGOs, governmental agencies, businesses, media and universities, aiming to provide a comprehensive overview of the ways in which businesses do or may impact human rights in a local context.

Stronger Together**:** A multi-stakeholder business-led initiative aiming to reduce modern slavery. It provides guidance, training, resources and a network for employers, labour providers, workers and their representatives to work together to reduce exploitation. It offers "The Progress Reporting Tool", an online self-assessment tool that supports companies globally to measure progress made in addressing modern slavery risks and to highlight the next steps for their businesses and supply chains.

Social factors and financial materiality

7. Trustees are required to have a policy on social factors they consider to be financially material. Trustees should seek to understand and manage the financially material risks and opportunities associated with social factors, in the same way they manage other risks that could have a financially material impact on the pension scheme. We have set out below some different ways in which social factors may be financially material. In practice, there will often be overlap between these categories.

Regulatory risks

8. Regulatory risks may arise where changes in public policy impact on the business model and/or value of trustees' underlying investments. These policy changes could be at the domestic or international level, impacting the different global markets in which companies operate. They may impact factors such as the cost of operating, or introduce liability for previously legal practices. Examples of these types of risks include the possible impact on technology companies' business models of tighter data and privacy regulation.

9. Companies that have poor practices on health and safety and wider workplace regulation may also experience increased costs in relation to accidents at work, staff absences and associated HR and legal costs. These will increase operating costs and decrease profit.

Litigation risks

10. Companies may be exposed to legal action in situations where they have contravened local and international laws, for example in relation to human rights, health and safety, or workforce practices in supply chains. This can result in costly legal fees and the requirement to pay damages as well as leading to reputational damage that can impact profits.

Reputational risks

11. Poor performance on social factors can damage companies' reputations. This may cause a sudden impact on brands or it might be the slow drip-drip of bad press that shifts public opinion, leaving a company more exposed to competition and to ongoing campaigns or boycotts. This might also evidence itself in calls for stronger regulation.

Opportunities

12. Social factors can also be opportunities. Companies' sustainability standards can set them apart from competitors and tap into increasing consumer demand. Higher standards on social factors may be a commercial advantage. This may also impact on existing businesses, which will need to keep pace with changes. It may also favour innovation, new ways of doing business and new global markets. Not all such opportunities will be appropriate for pension schemes' investments but the higher risk profile from investment in smaller companies may deliver higher returns.

Systemic risks?

13. One of the reasons why climate change poses such a serious risk to financial markets and investments is that it is systemic. We use this term to refer to a risk that can trigger large-scale changes to the financial system, in particular where the impacts will cascade or multiply once a tipping point is reached. For example, the sudden re-pricing of companies' assets and/or the physical impact of climate change on assets poses the risks of a severe shock to the value of investments. The risks associated with climate change are also difficult for investors to avoid through stock selection, for example, as they are spread across sectors.

14. Some social factors may pose similar kinds of risks. The Covid-19 pandemic is a public health crisis that has had a wide-reaching impact on the global economy.

15. However, many social factors pose a slightly different type of risk, as market risks across different sectors. These may be unlikely to pose sudden, unexpected shocks, but they can be difficult for investors to avoid through diversification. For example, we may see business models and poor practices in supply chains replicated across sectors in a "race to the bottom". This means that unless investors are willing to screen out whole sectors, they will be exposed to social risks across their portfolios.

Quality of life

16. Some have also argued that pension trustees should consider the quality of the world into which their members will retire. As a non-financial factor, we are not proposing to explore this idea in this call for evidence, but we acknowledge that there is a connection between the investments made by pension schemes and the real economy, both now and in members' later life.

Case studies: Social factors as failings and as opportunities

Boohoo – failings of the system

In 2020, Boohoo's share price fell over 50 per cent after it was alleged that it was sourcing clothes from UK suppliers that were treating employees unfairly and paying workers less than the national minimum wage.

Boohoo commissioned an independent inquiry, the Levitt report, which found that there were significant inadequacies in the supply chain, as well as some major breaches of the UN Guiding Principles on Business and Human Rights. Multiple instances of abusive practices were reported, as well as direct warnings to Boohoo executives from their own auditors that workers were being subject to appalling conditions.

Despite these findings, Boohoo's share price rose 15 per cent as a result of the publication of the Levitt report. This suggests misalignment between the market and "good practice" on social factors, and points to the complexity of these issues. The company has since spent money investing heavily in monitoring and finding better suppliers and made a board director responsible for ethical sourcing. Some 64 bad suppliers have been ejected.

Sports Direct – workers' conditions and share price

In 2016, a report by the Business, Innovation and Skills Committee found that Sports Direct founder Mike Ashley must be held accountable for company failings. One person giving evidence to the Committee compared the warehouse to a Victorian workhouse, which had no place in 21st Century Britain.[16] Mike Ashley also put on record, at the oral evidence session, that workers had been paid below the minimum wage.[17] The company's share price fell after these findings were made public.

[16] See page 8, para 18 of the Report.
[17] See page 27, para 5 of the Report.

To restore confidence, the retailer pledged to consider giving more of its warehouse staff full time contracts with Sports Direct and warehouse pay was increased by 20p an hour above the national minimum, to prevent breaching the legal minimum pay rates. However, the company continues to face accusations of failings on working conditions[18]. Repeated social failures and the press attention generated from this, has had a negative impact on the company's share price and reputation.

Questions

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?**

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?**

[18] https://www.retailgazette.co.uk/blog/2020/09/sports-direct-warehouse-accused-of-breaching-covid-19-guidelines/

Chapter 3: How trustees can take social factors into account

1. Acting in members' best interests requires schemes to invest in a way that will provide an appropriate return over the long-term, not just the highest possible returns available today. Research by the Pensions Policy Institute found that investing in assets with good ESG credentials could increase an individual's pension pot size at State Pension Age by around two per cent.[19]

2. There is no single "right" way to consider social factors but there are several distinct approaches available:[20]

   - **Screening (exclusion):** A simple way of avoiding investments in assets associated with poor performance on social factors is by excluding particular companies or investment in particular areas (e.g. controversial weapons). Screening can also be used to choose investments in companies that exhibit particular positive aspects.
   - **Tilted funds:** Strategic tilting can be used by schemes to tilt the portfolio's exposure to companies performing well on social "scores". Similarly, schemes can tilt their portfolio away from lower scoring ESG assets or sectors that have performed poorly on social issues.
   - **Social impact investing:**[21] Investments made with the intention of generating a positive social impact alongside the financial return. This is something trustees may do to take into account social issues, but they should only do this if it is compatible with their fiduciary duty to act in the best financial interests of scheme beneficiaries.
   - **Voting:** Voting in a way that supports social considerations, either directly or via an asset manager.
   - **Engagement:** Engaging with companies on social issues, either directly or via an asset manager.

Implementation considerations

3. Each of the approaches at paragraph 2 above involve different implementation considerations that trustees will need to take into account in order to establish an effective strategy based on consideration of social factors:[22]

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[19] PPI "The DC Future Book" (2019)Silcock, Adams & Pike [PPI] (2019) https://www.pensionspolicyinstitute.org.uk/media/3270/20190919-the-dc-future-book-2019.pdf
[20] PPI "The DC Future Book" (2020) https://www.pensionspolicyinstitute.org.uk/media/3615/20200923-the-dc-future-book-in-association-with-cti-2020-edition.pdf
[21] Defined by the Organisation for Economic Co-Operation and Development as "the provision of finance to organisations addressing social needs with the explicit expectation of a measurable social as well as financial return".
[22] These implementation approaches are set out in PPI's "The DC Future Book" (2020).

- **Level of financial risk-mitigation:** the extent to which a particular strategy is likely to reduce financially material risks.
- **Cost:** The cost of entry to an investment, as well as ongoing costs associated with management and engagement.
- **Delivery method:** For example, whether the social strategy is implemented through a platform, through an asset manager or directly by the scheme.
- **Governance:** The amount of governance (expertise, available time and organisation efficiency) dedicated to conducting due diligence on the approach and its effective ongoing management.
- **Scheme type:** The approach taken to social factors will depend on the type of scheme. For example, larger schemes may have more resource to engage and vote.

Stewardship - voting and engagement

4. A particular focus in this call for evidence is stewardship (voting and engagement), which is a core approach trustees can utilise to take social factors into account.
5. Stewardship is not a box-ticking exercise. For stewardship to be effective, investors like pension scheme trustees need to understand their investments and the issues they face and be willing to have a meaningful dialogue with management. Although many scheme trustees invest passively and in pooled funds, trustees can still take account of social factors through their choice of fund and asset manager and through conversations with those managers.
6. Where schemes delegate to their asset managers, they need to be able to understand what their managers are doing, to monitor them, and to hold them to account. A good voting policy would set out the scheme's position on environmental, social and governance issues. Where voting is delegated to managers, a good policy would set out how schemes check their manager's approach (some asset managers' policies currently offer limited coverage of social topics[23]) and the steps that will be taken where the managers' voting choices diverge from the scheme's voting policy.
7. At present it is not clear that stewardship is happening at a high standard across the pension sector. And although asset managers frequently report on stewardship activity via engagement themes, numbers of engagements or individual case studies, it may be difficult to understand the impact of that stewardship in the round.
8. In November 2020, HM Treasury's Asset Management Taskforce made recommendations to Government on stewardship in its report "Investing with

[23] Share Action. Point of No Returns. 53 per cent of the surveyed asset managers report that their voting policy covers human and labour rights, although few make specific voting commitments in this area. Around 32 per cent explicitly state support for inclusion and diversity at investee companies, however, for the most part, this is limited to board-level gender diversity.

Purpose"[24]. These included two recommendations for the Department for Work and Pensions:

- **Recommendation 15:** "UK pension schemes should be required to explain how their stewardship policies and activities are in scheme members' best interests. TPR should issue related guidance on how trustees might evidence that their stewardship policies and activities are in members' best interests".
- **Recommendation 16:** "A dedicated council of UK pension schemes should be established to promote and facilitate high standards of stewardship of pension assets. Members of the council should either be signatories of the UK Stewardship Code or have publicly committed to signing the Code within two years of joining the council."

9. Recommendation 15 seeks to raise the standard of stewardship across the pensions sector. An obligation to explain the connection between stewardship and members' best interests sets the expectation that trustees are considering this and may raise the standard of trustees' policies and improve best practice.

10. Recommendation 16 would see the Department support the creation and running of the council as a network for trustees of occupational pension schemes and similar investors[25] interested in developing their own capacity for stewardship and raising standards across the sector. This would be a mechanism to enable the sector to do better stewardship through peer support and would help to improve the quality of pension scheme trustees' engagement with consultants and asset management, driving up standards across the investment chain.

11. The Government welcomes both recommendations and is closely considering both. We are currently investigating the feasibility of a stewardship council for occupational pension schemes.

Questions

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?**

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?**

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?**
   (b) If yes, please provide details including why you felt this was necessary, what was done and the impact of your intervention.
   (c) If no, then please provide details including what disincentives and

[24] https://www.theia.org/sites/default/files/2020-11/Asset%20Management%20Taskforce_proof7.pdf
[25] UK occupational pension schemes (with encouragement given to larger schemes (i.e. those with over £1bn of assets)), authorised Master Trusts and local authority funds.

barriers you faced in undertaking stewardship activities (engagement or voting) with an investee company?

Chapter 4: Social factors as opportunities

1. We have set out above the law regarding trustees' legal duties and social factors, how trustees may understand social factors and how they may take these into account. This chapter considers how social factors may be investment opportunities for investors like pension schemes.
2. All investment must be in line with trustees' fiduciary duties, but this does not prevent trustees from exploring different investment opportunities and asset classes. The Government is already undertaking substantial work to understand and address some of the barriers to trustees investing in private markets including venture capital.
3. We want to understand whether there are similar misunderstandings about the availability and viability for schemes of investment products that see social factors as financially material opportunities for investors to make a return.
4. As set out above, trustees may take social factors into account in a number of ways. Tilted funds and stewardship can all be predicated on the view that investments that perform well on social factors are opportunities. In particular, scheme trustees may be interested in funds that include companies on the basis of their contribution to social issues or on the basis that the companies will benefit from greater engagement on social issues.
5. A further possibility for investment opportunities focuses on developing and emerging markets. We believe these investments are not as common for occupational pension schemes and would like to understand why.
6. In particular, in these markets there are examples of companies which have attracted venture capital funding or other large scale investment and been successful. For example, M'Pesa offers mobile money transfer services across Africa and Interswitch, a Nigerian digital payments company, secured $200m investment from Visa. In Latin America, a number of technology start-ups have been grown through venture capital and successfully matured through initial public offerings or mergers and acquisitions.[26] These markets may provide new sources of investment and return for pension schemes, as part of their wider portfolio.

Questions

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?

[26] For example, Mercado Libre and Globant both of which have since listed (on Nasdaq and NYSE).

Annex A: Are trustees taking social factors into account?

1. A high level review of a select set of SIPs for 25 large DB schemes and 15 large DC master trusts, found that most statements had a dedicated ESG section. The majority acknowledged that ESG considerations may have a material impact on investment risk and return. Most SIPs cited climate change as a key risk for schemes to manage.
2. Nevertheless, the majority of the SIPs reviewed did not differentiate between E, S and G factors. Policies or objectives to address social factors were in the minority. Most SIPs used boiler-plate wording around delegating investment management responsibility to asset managers, with brief assurances that the asset manager's policies are consistent with the trustees' ESG beliefs.
3. A minority of SIPs expanded on the social factors and selected specific areas to focus on. Common themes included gender diversity, labour standards and controversial weapons. The rationale for choosing to focus on specific social factors was limited.
4. Some SIPs for DC master trusts mentioned particular funds for members with 'stronger views'. Some of these self-select funds usually reported an 'ethical' position, and others focused on faith-based interests (e.g. Sharia investment principles).
5. Our analysis of the SIPs also looked at one of the main approaches for taking social factors into account – stewardship. Many SIPs stated the scheme's support for the UK Stewardship Code and UN Principles for Responsible Investment but most schemes were not signed up to the Code, or did not require asset managers to be signatories. On the whole, there was little detail explaining how trustees, or their managers, engage and vote on social issues.
6. We acknowledge that the SIP is just one source of evidence and we encourage schemes to respond to this call for evidence, to help build upon these initial findings.

Annex B: Questions

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?**

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?**

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?**

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?**

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?**

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?**

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?**

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

   (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?

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?**