Quick Start Guide for Pension Trustees

This guide from the Taskforce on Social Factors (TSF) aims to support pension trustees with activities to begin to identify and monitor social risks and opportunities of their scheme's investments.

What are social factors?

Social factors are considerations about an investment that relate to people – from workers and suppliers to customers and communities. This means looking at both the impact of social factors on an investment along with the social outcomes and impacts of an investment. Social factors include a wide range of topics from payment terms for suppliers, anti-microbial resistance, links to armed conflict, and vaccine fairness to the just transition, health impacts on consumers and communities and inequality.

Social factors can manifest at the company level (e.g. a social controversy may impair an individual stock price or sector level), and can also represent systemic risks. For example, social unrest due to inequality or geopolitical stress can affect entire markets, and the systemic effects of unchecked anti-microbial resistance could have global reach. These systemic risks cannot be mitigated through diversifying an investment portfolio, nor easily through stewarding/influencing individual companies.

Social factors impact all organisations, irrespective of their industry and geographical footprint. This means they are important for pension trustees: considering material social factors – along with reputational, operational and legal risks - can help increase the resilience, impact and value creation of investments. Social issues can be:

- material to individual companies and industries, and
- systemically relevant to entire portfolios and economies.

Social issues not only impact the potential performance of investments, but they also impact people. For pension savers, social factors will influence the world into which they will retire as well as the performance of their investments.

Trustees' influence over social factor stewardship

Pension trustees typically make decisions at portfolio or mandate level, rather than in relation to specific companies. Many pension trustees also invest through discretionary mandates, pooled funds or in funds of funds managed by a third party. It is trustees' stewardship approach and their oversight of their appointed advisers and fund managers that are the levers available to them for managing social risk and opportunities.

Fiduciary and other duties of pension trustees

Pension scheme trustees are called on by their fiduciary duties to integrate financially material factors, including material social factors, into their investment decision-making, in line with their duty to use their investment power for its proper purpose. They also have a duty of care when investing. Proactive consideration of relevant ESG issues (both risks and opportunities) is increasingly recognised as a driver of economic value, risk management, and sustainability. Where social factors are financially material like this, trustees should take them into account. Decision-making is aided by improving ESG analysis, which increasingly focuses on financial performance.

In the UK, legislation also requires trustees to invest scheme assets in the best interests of members and beneficiaries and to exercise their powers of investment in a manner calculated to ensure the security, quality, liquidity and profitability of the portfolio as a whole. Trustees have a responsibility to integrate financially material ESG factors into their decisions on investment and stewardship in order to support them in seeking the best possible risk-adjusted returns for the duration of their investments. The recent report from the Financial Markets Law Committee (FMLC) looking into the intersection of fiduciary duty and sustainability is an important piece to aid trustee understanding of the issues [LINK TO FMLC publication].

Social Factors and Pension Investment Regulations

Most occupational pension scheme trustees are required to have a statement of investment principles (SIP) which sets out their policies on how they take account of financially material considerations when making their investment decisions. These include environmental, social and governance (ESG) factors. Both Defined Benefit and Defined Contribution pension schemes must publish annual Implementation Statements, setting out their actions relating to stewardship aspects of the SIP.

Addressing social factors in pension schemes

A coherent approach to addressing social factors in pension schemes can help manage portfolio risk and broader systemic risks. TSF recommends these actions as a baseline, the minimum for trustees to include social considerations in policies and practices, acknowledging where the current size, type and resource constraints of schemes might impact application.

Once the foundations have been set, depending on scheme circumstances, it could be appropriate for the trustees to consider further development of their approach. Progress and improvements through the levels of practice may take a number of years.

For more detail on good and leading practice in this area, see Taskforce on Social Factors: Guide on considering social factors in pension scheme investments and Taskforce on Social Factors: Case Studies [LINK] for real world examples of incorporating social factors into pension scheme investments and stewardship.

Baseline practice
• Trustees to create a high-level investment and stewardship policy covering social factors, drawing out specific themes that are priorities for the scheme, including systemic risks and a commitment to respect human rights.
• Trustees to ask their investment consultants how social factors are integrated into their advice on asset allocation and fund research and selection.
• Trustees to include social factors-related questions / requirements into their selection, appointment and monitoring of investment managers, including regular review meetings.
• Trustees to increase their knowledge and understanding of social factors, including training sessions on social factors.

Questions for your advisers and service providers

Asking questions about how a scheme's asset managers and investment advisers' or consultants' approach social issues can help trustees gain insights into financially material social issues relevant to their portfolio.

Investment advisers and consultants

- How are social considerations integrated into their investment advice?
- How do they consider a manager's approach to social issues (including use of data) in evaluations and recommendations?
- How can they help trustees to determine which social issues most matter to them and to their beneficiaries?
- To what extent are they engaged with public policy and best practice debates and discussions on social factors?

Asset managers

- Which social issues for engagement are key priorities to the asset manager? How well do these issues align with the trustees' own priorities and assessment of what is financially material?
- What social metrics do they monitor when assessing an investment, and how are they measured?
- What role do social issues play in driving their financial assessment of a company?
- To what extent are they engaged with public policy and best practice debates and discussions on social factors?

Further reading

For trustees who want to take further action on integrating social factors into pension scheme investments, see Considering Social Factors in Pension Scheme Investments: Guide from the Taskforce on Social Factors