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Considering Social Factors in Pension Scheme Investments:

Guide from the Taskforce on Social Factors

Ministerial Foreword

The UK is a world-leader in the occupational pension schemes industry, and we are rightly proud of our record on embedding Environmental, Social and Governance (ESG) considerations. This is particularly true in relation to climate change, and our groundbreaking regulations to ensure trustees of larger schemes must report on climate related risks and opportunities. However, the "S" in ESG tends to be less high profile, due to social factors being sometimes more challenging to measure, varying from scheme to scheme or with changing priorities. This is why the former Minister for Pensions, Guy Opperman published a call for evidence back in 2021 and subsequently set up the Taskforce on Social Factors to raise awareness and develop a common understanding of social risks and opportunities which can be addressed by pension scheme trustees, industry and policymakers.

An independent industry-led taskforce was crucial in order to ensure that the views of not just large schemes, but also those schemes with fewer resources, asset managers and consultants were fully taken into account.

I am therefore very grateful to the group for producing a guide which covers how social factors align with trustees legal and fiduciary duties and why they may be considered financially material. More than this, the Guide provides practical assistance in the form of frameworks of good practice and to allow for the assessment of materiality.

Such tools - alongside the discussion of data sources and the accompanying directory - should allow pension scheme trustees to be better equipped when considering social factors within their investments and to hold asset managers and service providers to account where necessary.

I would like to thank the chair, the three co-chairs and all those who contributed to the Guide, for giving up their time willingly and producing a very thorough document which will provide useful assistance, as well as food for thought to trustees, assets managers and consultants, not to mention government and the regulators.

Paul Maynard

MP Minister for Pension

Chair Foreword

It has been a great honour to chair the DWP's Taskforce on Social Factors over the past twelve months and to lead such a fantastic group of senior industry professionals who with lots of knowledge, enthusiasm, and energy, have created this guide that I am sure will play a meaningful role in driving forward the much needed system-level change in the investment industry in the UK and, I hope, in the rest of the world.

Social factors have come to refer to several considerations for investors, such as organisations' workforce practices, especially labour rights and health and safety; supply chain and modern slavery issues; and inclusion and diversity.

Ultimately, social factors are all about people, how we come together as a society to produce and provide for each other, within the boundaries of our socio-economic and environmental systems. It is clear to me that the impacts of the transition to a low carbon economy and the physical impacts of climate change need to be addressed, but it goes far beyond that, particularly for pension funds and their trustees.

It is also clear that the reason why social factors matter is because they can be material for investment decision-making. Supporting pension fund trustees navigate such decisions was central to the work of the Taskforce, which has now created a user-friendly guide, so trustees are better able to understand and assess these factors.

The UK can be rightly proud of its world class pensions industry which has been at the forefront of many financial innovations and continues to find better ways to look after people's retirement savings. A reliable and supportive policy and regulatory environment has played a critical role in facilitating this advancement. Climate reporting was a game changer in the way the pensions industry thinks about systemic risks, and my hope is the work of this Taskforce will mark the beginning of a more holistic approach by pension funds to sustainability considerations in their investment decision-making.

The pensions industry in the UK is rightly recognised for its strong collaborative approach. Systemic risks can only be addressed through collective effort, and this Taskforce demonstrates how the industry can come together and create something practical and valuable, led by the pensions industry for the use of pension fund trustees.

Finally, I would also like to express my enormous gratitude to all the members and observers of the Taskforce and the consultation respondents for the invaluable contribution of their time and expertise throughout this initiative, as well as to the Pensions Minister and the fantastic team at the Department for Work and Pensions for their unwavering support.

Luba Nikulina

Chair Taskforce on Social Factors

Chief Strategy Officer, IFM Investors

Introduction

The Taskforce on Social Factors (TSF) was formed following the Department for Work and Pensions' (DWP) consultation on Consideration of social risks and opportunities by occupational pension schemes.[1] With representation from pensions schemes, asset owners, asset managers, investment consultants, data providers, cross-industry groups and civil society, the TSF aims to support pension scheme trustees and the wider pensions industry to consider social factors in pension scheme investments.

By providing practical steps to help consider social factors in investments, the TSF guide will help trustees of all pension schemes. Many schemes will be subject to specific regulatory requirements; this guide is designed to complement those regulatory requirements.

The TSF thanks the contributors and participants from across the pensions industry, who provided consultation responses, and attended roundtable discussions and focussed meetings to provide feedback throughout the development of the guide.

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DWP-appointed members

Hilkka Komulainen	Aegon
Ben Howarth	Association of British Insurers
Stephen Barrie	Church of England Pensions Board
Luba Nikulina	IFM Investors
Maria Nazarova-Doyle	IFM Investors
Joe Dharampal-Hornby	UKSIF
James Alexander	UKSIF
Doug McMurdo	Local Authority Pension Fund Forum
Sarah Wilson	Minerva Analytics
Joe Dabrowski	PLSA
Daniel Jarman	PPF
Caroline Escott	RailPen
Paul Lee	Redington
Rachel Haworth	ShareAction
Valeria Piani	The Phoenix Group

Government / Regulator members

Department for Business and Trade (DBT)
Department for Culture, Media and Sport (DCMS)
Department for Work and Pensions (DWP)
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Elena Espinoza	The Phoenix Group
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Heidi Douglas-Osborn	UKSIF
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Michael Jones	Eversheds Sutherland
Will Martindale	Canbury
Andrew Lewis	TraversSmith

Summary

The guide aims to provide pension trustees with the tools to identify and monitor social risks and opportunities of investments.[2] Recognising schemes will have different circumstances, resource levels and time horizons, the guide aims to provide a starting point for trustees to work further on with the help of their advisers and (if they have them) in-house teams.

Trustees need to consider the financial materiality of social issues to the scheme's investments and then develop approaches for the scheme's various asset classes and investment strategies, drawing from available data sources and frameworks.

The guide supports pension trustees in embedding social factors within schemes' investment decisions and stewardship policies in four sections:

- **Social factors and pension funds** explores why social factors are important from an investment perspective, and how taking account of these considerations aligns with pension trustees' fiduciary duties.
- **Addressing social factors in pension portfolios** provides a framework with Baseline, Good and Leading practice indicators, along with a deep dive into modern slavery and how trustees can approach this social factor in their investments[3]
- **Materiality assessment framework** provides an example top-down approach for pension schemes.
- **Social factor data** discusses data trustees can use to manage social factors in investment.

Further publications from the TSF to support integrating social factors into pension investments include:

- **Quick Start Guide** for pension trustees
- **Recommendations** for the pensions industry, government and regulators
- **Data Sources** directory
- **Effective stewardship, investment and advice services Guide**
- **Case studies** of examples in practice.

1 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1091035/government-response-to-dwp-social-call-for-evidence.pdf
2 The guide is not a reporting framework.
3 A key objective for the Taskforce defined by DWP was to develop thinking around how trustees can identify, assess and manage the financial risks posed by modern slavery and supply chain issues.

1. Social factors and pension funds

This section explores why material social factors are important from an investment perspective, and why taking these into consideration aligns with pension trustees' fiduciary duties.

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), 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 and Pension Regulation

Most occupational pension scheme trustees are required to set out how they take account of financially material considerations when making their investment decisions in their Statement of Investment Principles (SIP). 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. The Pensions Regulator plans to assess the extent to which SIPs and Implementation Statements deliver on expectations.

See: Reporting on Stewardship and Other Topics through the Statement of Investment Principles and the Implementation Statement: Statutory and Non-Statutory Guidance - GOV.UK (www.gov.uk)

Social factors are inseparable from business and investments. Businesses both cause and are affected by social impacts; for example, workforce conditions, remuneration practices, bribery, health and safety, and modern slavery. Social factors impact all organisations, irrespective of their industry and geographical footprint.

Social considerations 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. Taking account of social factors, along with environmental and governance (i.e. ESG) risks and opportunities as part of a pension trustees' investment decisions and stewardship policies can create positive value and help secure long-term risk adjusted returns for pension scheme members.

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, they impact people. For pension savers, social factors will influence the world into which they will retire.

In 2021, the UK Government consulted on pension trustees' consideration of social factors when making investment decisions. It identified several lenses through which it is useful to view social factors:

- practices within a company,
- practices within a company's supply chain,
- company products and selling practices, and
- a company's impact on the community.

A company (and its investors) may reap some short-term benefit while causing, contributing to or ignoring adverse social impacts. But there is likely to be a longer-term cost, companies risk losing their social license to operate if they are associated with social related failures. Pension funds too may be vulnerable to 'social license' concerns, which could potentially impact employer covenants, for defined benefit pension schemes, or cause reputational damage. Social impacts can also spill over into other businesses or even sectors, thereby creating systemic risk. For example, poor industrial relations may cause strike action, which can cause wider impacts on a range of businesses. Finally, there may be reputational damage on pension schemes for investing in companies causing social harm or failing to contribute to social progress.

Historically, though there are some notable exceptions like engagement with banks in the era of apartheid South Africa, and restrictions on investing in weapons of mass destruction, many pension funds and trustees have shied away from engaging on social issues due to a lack of clarity on how to gauge materiality and a lack of knowledge or confidence to raise issues with investee companies.

Events like the 2020-2023 Covid pandemic however demonstrate in real-time the multiplying effect of social issues interacting (such as lack of access to healthcare and social support networks). It underlined that greater attention, understanding and engagement is needed across a range of social issues. Equally, there is increasing awareness among investors and policymakers that the costs of climate inaction are falling on the shoulders of particular segments of global society. Achieving an orderly and just transition to net zero requires extensive stakeholder engagement, including on issues such as low pay, poor health, and social inequalities that leave individuals and communities more vulnerable to climate change and other social shocks.

As a result, the scope of social factor analysis should not be too narrowly constrained to matters in the direct or immediate control of a business, and should extend along the value chain. Analysis on corporate performance on social factors can also be used as a proxy indicator of poor management, indicating risk control and stakeholder management failures in the company.

Trustees' influence over social factor stewardship

Pension trustees typically make decisions at portfolio or mandate level, rather than in relation to specific companies (though some have company-specific restriction lists or some level of in-house investment capabilities). Many pension trustees also invest through discretionary mandates, pooled funds or in funds of funds managed by a third party. So 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.

There are also key opportunities for trustees to influence the fund managers and investment consultants they work with. These include before appointment and during formal reviews which enable trustees to gain confidence in the manager's and consultant's approach to integrating social factors into their stewardship, investment and advice approaches, and to use these review points to leverage change where that is seen to be needed. TSF's Guide on effective stewardship, investment and advice services provides more detail on oversight of asset managers, consultants and data providers, including questions to ask, what good answers look like and things to include in mandates and side letters.

Currently, there is insufficient consistent and comparable information on how companies approach the full breadth of these issues, limiting the scope for investor scrutiny and challenge. But, the investment community, especially asset owners, are gradually demanding more, and better, information. Stewardship policies of many investors cover engagements on social factors and shareholder proposals have been increasing at publicly listed companies.[3]

Pension schemes can also engage in stewardship with stakeholders like government, regulators and policy-makers, providing practical insights and seeking to influence law, regulation and policy on social factors effecting investments. This engagement may be done as part of a collaboration with other investors and stakeholders. Engagement can also take place with standard-setters and others producing investment frameworks, for example seeking integration of social factors into standards and frameworks, as well as interoperability between frameworks to support investors.

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 broad and wide-ranging powers of investment to integrate financially material ESG factors into their decisions and seek the best possible risk-adjusted returns for the duration of their investments.

Pension investment regulations

In 2018, the DWP updated the Occupational Pension Schemes (Investment) Regulations 2005 to make clear that trustees who are required to prepare a statement of investment principles (SIP) should have policies on how financially material ESG factors are integrated into their investments. DWP has also updated the Occupational and Personal Pension Schemes (Disclosure of Information) Regulations 2013 to require new disclosures by Defined Benefit and Defined Contribution pension schemes including in relation to the contents of their SIPs..

The changes clarified that the financially material considerations to address here include, but are not limited to, environmental, social and governance factors, including climate change over the "appropriate time horizon" of the investments.

Both Defined Benefit and Defined Contribution pension schemes must publish annual Implementation Statements, setting out their actions relating to stewardship aspects of the SIP.

In 2024, the Financial Markets Law Committee (FMLC) published a paper on Pension Fund Trustees and Fiduciary Duties[5] to provide an explanation of the legal position. Following a review of fiduciary duty in the UK, and its intersection with sustainability and climate change, the paper draws some clear conclusions in a number of important areas, including investment decision-making, stewardship, investment advice, modelling, the role of trustee judgement and qualitative information, member consultation and others. Describing sustainability as important to pension schemes, as well as to economies as a whole, the paper sets out pension trustees' responsibility to act to achieve the purpose of the pension trust in the interests of the scheme's beneficiaries.

FMLC's paper builds on the Law Commission's 2017 report on Pension Funds and Social Investment to confirm that what distinguishes a financial factor is the motive underlying its consideration, not the nature of the factor being considered. Given that sustainability-related issues can clearly impact on an investment's risk and return, trustees need to consider the extent to which they are (or may be) financial factors and, if so, take into account. Notably, the current legal framework requires trustees to take financial factors into account in investment decision-making, and the FMLC's paper makes clear that the scope of what is (or can be) financially relevant to a pension scheme is extremely broad. The paper encourages trustees to think about financial materiality on a number of different levels: the individual investment, the portfolio, and the whole economy.

The paper sets out that trustees need to consider relevant matters, including sustainability matters, in setting strategy, principles and policies and taking decisions concerned with investment and stewardship, taking a broad perspective and a long-term outlook, with the benefit of investment advice and working with investment managers. Trustees can apply this reasoning to considering social factors in investments, noting that

4 Social-related shareholder proposals have increased since 2018, from 62 to 101 in 2021 (with 22 and 39 passed respectively), according to a survey of Russell 3000 companies https://www.conference-board.org/publications/pdf/index.cfm?brandingURL=human-capital-management-proposals-brief-2

5 FMLC Pension Fund Trustees and Fiduciary Duties: Decision making in the context of Sustainability and the subject of Climate Change

they may become financially material over time, and it is important to take an appropriate view of investments to reflect the scheme's obligations to beneficiaries.

Positive and negative social impacts

Investors can be connected to negative social impacts in different ways, so understanding this connection can also clarify the type and level of action to take to mitigate or remediate the impact. All investments have real world impacts that can be positive or negative on workers, customers, indigenous people and local communities, along with other social impacts – trade-offs are involved in making investment decisions as well as within management of assets and projects on the ground.

While integrating financially material social factors into investment decision-making and implementation is expected of all investors, some asset owners, including pension trustees, are also looking to generate positive social outcomes through the scheme's investments – this is known as social impact investment. Social impact investments are made with the intention of generating a positive, measurable social impact alongside a financial return. Investments can be in any asset class or sector, with investors targeting various social outcomes and then measuring the direct impact of investments with quantifiable metrics.[6]

In 2020, the Impact Investing Institute published a legal paper, attested by five leading law firms, that explains how fiduciary duties and impact investing are compatible. The Institute has also published case study examples of pension funds that have benefited from successful integration of impact by their investment managers into investment decisions to help others do the same. When it comes to a greater focus on social factors, impact investing can play a significant role.[7]

Systemic risks and Universal Ownership

Systemic risks such as climate change and the just transition to net zero, rising inequalities, health and nature degradation have a profound effect on societies, economies and markets, affecting investment values. The nature of systemic risks means they cannot be avoided or mitigated by diversifying an investment portfolio away from them. They will impact across economies as a whole, wherever and however investors choose to invest. So asset owners need to seek to address these systemic risks directly and it is increasingly recognised that market participants can influence systemic issues.

Asset owners like pension trustees invest on behalf of their beneficiaries/clients/governments over a multi-year/multi- decade horizon, meaning that the pension obligations they are responsible for have a greater exposure to the long-term risks posed by the transition, and subsequently need to act appropriately to protect themselves, and benefit from opportunities.

The political environment

ESG factors (and other investment considerations) are shaped to a certain extent by the political environment and political decisions. This means the way that investors approach ESG considerations may have political implications, especially when related to high-profile activities and issues where trade-offs are required. This can occur, for example, when a company is seeking to deliver a new project which has political support because it will create jobs and growth, but may come at environmental or social costs which present investment risks. The transition to net zero is another example, which, alongside creating new jobs, could also lead to the loss of employment for workers in other communities.

Given the inherent investment implications of not addressing ESG issues, investors need to navigate the risks of politicisation carefully. As part of addressing social issues, investors should, where possible, engage a wide range of stakeholders, including pension scheme members, to understand different perspectives on the issues and risks. That way, investors can be confident in the positions they take on social factors and seek to address them with investee companies.

A number of pension funds globally have grown in size and significance and have started to think of themselves and behave like Universal Owners. Universal Owners (UOs) have large, diversified portfolios of investments that effectively represent a slice of the global economy. As UOs own part of the economy, there is "nowhere to hide" from systemic issues as they will all materialise in their portfolios if not managed well.

The rise in pension scheme asset ownership to over $60trln globally versus the global market capitalisation of c.$100trln means that not only are they now collectively able to influence economy-wide systemic risks, thus affecting systemic risks applicable to their portfolios, but also this becomes an important part of their role in managing portfolios. Managing such well-diversified portfolios becomes closely interlinked with managing the market beta – you can think about it as "the rising tide lifts all boats". If the market at large does well, so will UOs. With the advancement of passive investment strategies, it can be argued that smaller pension funds are also UO-like and that it's not just the largest schemes that are affected, but all schemes. It follows that pension funds have a direct economic interest in influencing systemic issues.

6 Home | Impact Investing Institute
7 Impact-investing-by-pension-funds-Fiduciary-duty—-the-legal-context.pdf (impactinvest.org.uk)

The political environment

How businesses can best attract and retain their human capital and staff, including through re-training programmes, enforcing workforce protections, and taking care of employees' physical and mental wellbeing, will be crucial to almost every company's long-term success. The US Securities and Exchange Commission has stated that human capital is a key, material resource for companies. Promoting a more inclusive, fair and diverse work environment is a key social factor that can promote long-term value across all sectors of the economy, and there are clear opportunities from active consideration of social issues.

The concept of the 'Just Transition' is another example of how social factors may directly matter to pension schemes' investment strategies. In recent years, climate risk has become central to many investment decisions made by pension funds. The 'Just Transition' recognises that there will be social barriers to necessary decarbonisation of our economies if the interests of affected workforces are not actively taken into account. The pensions industry has grasped that climate risk is highly significant, but has yet to respond sufficiently to this associated social imperative. An unsuccessful net- zero transition is a clear systemic risk. Pension funds can assist in managing this risk by insisting that more attention is paid to these social factors.

See: https://www.lse.ac.uk/granthaminstitute/financing-a-just-transition/

Institutional investors should take into account a wide range of social factors in their investment activities, such as human rights under pillar 2 of the United Nations Guiding Principles on Business and Human Rights (UNGPs), which complement environmental and other ESG factors. Investors can be involved in potentially negative human rights outcomes and social impacts through their own business activities and operations or through their business relationships and investment activities that induce or facilitate such negative outcomes, which ultimately may impact the long-term sustainability and viability of investments.

Investors, as well as the companies they invest in, are responsible for managing actual and potential negative human rights outcomes, typically in their broader supply chains. Companies will primarily be the ones causing or contributing to negative outcomes (directly or indirectly) and be responsible for providing remediation. Nevertheless, institutional investors should use their leverage (through engagement and wider stewardship activity), alone or jointly with other stakeholders, to ensure the companies they invest in manage these risks appropriately to ensure harm is prevented.

While the UNGPs are not legally binding, the UK has created an action plan for implementing them which has, amongst other things, resulted in the Modern Slavery Act. It is not only companies that risk losing their social licence to operate if they are associated with social-related failures. Pension funds investing in these companies may be vulnerable to challenge too. Recent NGO campaigning, and even legal action (which has to date focused on climate change) demonstrate increasing levels of scrutiny.

Materiality and salience of social factors

To effectively analyse social factors, trustees should understand and consider both salience and materiality. Material risks are those that have the strong potential to effect tangible, negative impacts on an investee company. Salient risks take risks to people as the starting point. The difference between material and salient impacts is not the same as the difference between financial and non-financial ESG considerations.

Salient and material risks can be interlinked. For example, remediation from salient human rights issue may not even account for a rounding error on a company's balance sheet, but could have knock on material impact on the company's reputation and staff retention, or may raise litigation and regulatory risk. Other risks might be salient but not necessarily material because mechanisms to make them material are not (yet) in place. For example, telecommunications firms may recognise the right to privacy as a salient risk, but because there are no privacy regulations currently in place to impact their business model the risk is not material. The same is true of artificial intelligence in the tech industry. Trustees should consider paying attention to both materiality and saliency, and not focus on current materiality alone given the interdependencies and interactions with salience and evolving regulation.

A way for investors to identify and prioritise the most salient social issues is to consider the severity of the issue. Severity can be assessed using the following parameters:

- Scope – number of individuals affected;
- Scale – how serious would the adverse impact be for the affected stakeholder(s);
- Remediability – any limits on the ability to restore those affected to a situation at least equivalent to their previous situation;
- Within this assessment, investors can also consider the likelihood of whether the risk will occur.

Even where the -scale of a pension scheme's financial exposure to modern slavery risk is relatively low, those risks may still potentially cause significant harm to the people impacted.

Cause	Contribute to	Directly linked
Direct connection between the impact and the investors own business activities	Investment activities induce, facilitate or incentivise other actors to have adverse impacts on human rights or social issues	Linked to adverse impacts through the activities, products or services of an investee company
Responsibility to cease and prevent impact and provide remedy	Responsibility to cease or prevent contribution to impact and cooperate to provide remedy	Responsibility to use leverage to influence responsible entity to cease and prevent impact and provide remedy

2. Addressing social factors in pension portfolios

This section provides a framework for addressing social factors in pension schemes, providing baseline, good and best practice indications, with a deep dive into the issue of modern slavery and how trustees can approach this social factor in their investments.

Framework for 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. This section of the guide recommends a framework by which trustees may include social considerations into their policies and practices. The framework serves as a guide divided into three tiers: baseline practice, good practice and leading practice. Each tier comprises a series of recommended actions, along with examples. Schemes can advance through the tiers of the framework, using a progressive approach to improving the scheme's approach to managing financially material social risks and to benefit from opportunities.The framework aims to encourage ambition from trustees, however the current size, type and resource constraints of schemes might impact the level that can be achieved. The framework has been designed to encourage efforts towards the progressive improvement of trustees' practices by giving them an understanding of what could be considered as best practice and encouraging them to adopt the practices that are achievable for their circumstances.

Schemes do not need to meet every suggested Good or Leading practice standard – trustees may consider their schemes to be achieving Good or Leading practice once they meet at least two of the standards in a higher category. Progress and improvements may take a number of years.

Baseline practice

Trustees should create at least a high-level investment and stewardship policy covering social factors, drawing out those specific themes that are key for the scheme, including systemic risks and a commitment to respect human rights.

Trustees should ask their investment consultants how social factors are integrated into their advice on asset allocation and fund research and selection.

Trustees should include social factors-related questions/ requirements into their selection, appointment and monitoring, including review meetings, of investment managers.

Trustees should increase their knowledge and understanding of social factors, including via teach-in and training sessions.

Good practice

Trustees meet all baseline practice.

Trustees demonstrating good practice would carry out a materiality assessment of the scheme's key risks and opportunities for social factors, with due regard to the type of investment via asset classes and geographies (for example, using a materiality assessment framework presented in this report).

Following the materiality analysis, trustees would prioritise the most relevant social factors and highlight these as stewardship policy priorities, integrate into voting guidelines and share with managers as Expression of Wish (or execute their own proxy voting).

Trustees would integrate social considerations into manager appointments and ongoing oversight – looking at investment strategies (including risks and opportunities) and managers' stewardship approaches, as well as their firm-level organisational credentials – engaging managers on the findings of ongoing monitoring and the scheme's materiality analysis and risk assessments.

Good practice continued

Ongoing reporting from the trustee's investment consultant and asset managers to trustees on integration of social factors would include:

- quantitative metrics for investment funds;
- reporting on engagement on social themes;
- vote reporting related to key social issues identified by the scheme as priorities.

Trustees would also engage with other schemes to improve their understanding and help bolster industry's stewardship of social factors, for example via membership of Occupational Pensions Stewardship Council (OPSC)[8] and signing up to the Asset Owner Diversity Charter.[9]

Trustees would also engage with their scheme members to understand their priorities when it comes to addressing social factors, and take these into consideration where appropriate.

Trustees in this category would consider taking part in collective stewardship efforts on Social initiatives, eg UNPRI Advance.

Trustees of DB schemes looking for buy-in/buy-out would assess the receiving insurer's portfolio Social (and other stewardship related) credentials.

For insured scheme/schemes using a platform, trustees might send an Expression of Wish to their platform provider.

Trustees would have policies covering social factors within their own operations i.e. gender and ethnic diversity, financial inclusion, supply chains focussed etc.

Leading practice

Trustees meet all baseline and good practice.

Trustees have a clear voting policy on social factors, that is publicly accessible and holds directors to account – market leading practice in this area also includes direct communication with companies either in advance of the AGM or in relation to votes cast.

Trustees consider allocating to non-concessionary social impact investment strategies, often in the form of direct investments eg in social housing, education etc.

Trustees (or their executive representatives) may lead social issues-related initiatives as founding investors and / or participate in relevant working groups.

Trustees would carry out engagements on social factors with top portfolio companies – either directly or via collaborative initiatives to ensure the asset owner voice is heard by investee companies.

Trustees could also encourage other market participants to align and improve, including data providers, ratings agencies, asset managers and investment consultants – by clearly outlining asset owners' needs.

Schemes demonstrating leadership would be signatories to the FRC's UK Stewardship Code[10] and provide regular external reporting on progress on social factors in investment and stewardship.

Trustees would undertake demonstrable policy advocacy and work with regulators and the government to improve practices around social factors.

8 https://www.gov.uk/government/groups/occupational-pensions-stewardship-council
9 Asset Owner Diversity Charter - Diversity Project diversityproject.com/asset-owner-diversity-charter/
10 2020_Corporate_Stewardship_Code.pdf www.frc.org.uk/library/standards-codes-policy/stewardship/uk-stewardship-code/

An example of addressing social factors: modern slavery considerations for pension investors

Modern slavery occurs in every region of the world. Each day, more than 27 million people across the globe are likely to be subject to a form of modern slavery, and around 12% of these are children[11]. These numbers have increased from around 25 million since 2016[12].

There are increasing regulatory expectations on companies and investors globally to address any issues relating to modern slavery. This means trustees should consider how their investments are exposed exposure to modern slavery.

What is modern slavery?

- Modern slavery is described by the Independent Anti-Slavery Commissioner as an "umbrella term" that comprises a range of offences covered by the Modern Slavery Act 2015 - slavery, servitude, forced or compulsory labour and human trafficking.
- People experiencing modern slavery are subject to exploitation and face threats, punishment, violence, coercion and deception. They are unable to leave their situation.
- Occurs in every region of the world and driven by structural inequality. Each day, more than 27 million people across the globe are likely to be subject to a form of forced labour.
- Which renders certain communities or workers particularly vulnerable to exploitation. Many goods and services are linked to modern slavery - the highest risk global sectors are currently services (32% of worldwide cases of modern slavery), manufacturing (19%), construction (16%), agriculture (12%) and mining/quarrying (8%).

In the UK, sectors considered to be high risk for modern slavery, include agriculture, construction, fashion and textiles, hand carwashes and care, affecting both UK nationals and migrant workers.

Why should trustees consider modern slavery?

The UK Modern Slavery Act (MSA) sets an expectation that businesses, including some pension providers, act to address this issue. Pension trustees also need to consider the risks associated with modern slavery in relation to investee companies. Businesses with modern slavery in their supply chains, whether intentionally or not, could suffer in many ways which would impact their financial performance. These include:

- criminal sanction or legal challenge
- loss of market access, such as import bans
- loss of access to capital (de-listing from stock exchanges)
- loss of government procurement contracts and other opportunities
- financial sanctions and asset freezing or confiscation
- disruption and delay in supply chains where modern slavery has been discovered
- reputational damage
- failure to attract and retain customers.

These impacts can result in unanticipated loss of shareholder value, particularly where addressing issues increases costs, for example, where a company can no longer rely on low-cost suppliers.

Legal and regulatory landscape

Regulatory regimes covering modern slavery are expected to develop further in the coming years. Some recent developments include:

Under the UK Modern Slavery Act (MSA), businesses with an annual turnover of more than £36m must produce an annual modern slavery statement, setting out the actions being taken to prevent modern slavery across supply chains. However, there has been some criticism on the quality of MSA disclosure by companies, and in the financial services sector in particular.

Also in the UK, any financial services provider found to be holding the proceeds of modern slavery may potentially be liable under anti-money laundering legislation.

Australia and Canada have also adopted their own modern slavery legislation.

The US has imposed import bans on gloves associated with allegations of forced labour, and other countries have introduced, or are considering introducing, bans on imports associated with modern slavery.

In 2022, the EU began the process of implementing a Corporate Sustainability due diligence directive.

The aim of this directive is to foster sustainable and responsible corporate behaviour and to anchor human rights and environmental considerations in companies' operations and corporate governance.

Modern slavery contributes to economy-wide risks. For example, there is often a link between modern slavery and organised crime, including money laundering. It is important to consider the saliency of these risks - a pension scheme's financial exposure to modern slavery risk may be relatively low but the risks may cause significant harm to the people impacted.

Savers can also prioritise human rights issues, such as modern slavery, when considering how their money is invested. The sustainability of pension options is already one of the top four benefits people look for when choosing a new employer.[13] Trustees could find it helpful to be aware of members' preferences with regards to addressing modern slavery risk.

11 Global Estimates of Modern Slavery, Scottish Widows, p.2 www.ilo.org/wcmsp5/groups/public/---ed_norm/---ipec/documents/publication/wcms_854733.pdf
12 Global Estimates of Modern Slavery, Scottish Widows, p.21 www.ilo.org/wcmsp5/groups/public/---ed_norm/---ipec/documents/publication/wcms_854733.pdf
13 Global Estimates of Modern Slavery, Scottish Widows, p.4 www.ilo.org/wcmsp5/groups/public/---ed_norm/---ipec/documents/publication/wcms_854733.pdf

Addressing modern slavery in pension investments

Investor practices to understand and address modern slavery in portfolios are still developing. Some examples of good practice are highlighted in the Taskforce on Social Factors: Case Studies. More work is required for more investors to meaningfully address the investment risks of modern slavery and to support its eradication. When implementing the guidance this report sets out with a modern slavery lens, trustees should take note of the following:

- **Data availability.** There is a gap in the market on meaningful and outcomes-based data for investors to use in assessing modern slavery risk and how companies manage it. Identifying modern slavery risk in the portfolio therefore relies heavily on identifying high risk geographies, sectors and business models.
- **Identifying risk to people**. Investors may need to shift their focus from their largest holdings to the areas with highest risk to people when seeking to identify modern slavery and other human rights risks, remembering that simply removing investment from some industries or regions could result in greater poverty, and possibly displacement, with the potential unintended consequence of increasing the risk of modern slavery.
- **Modern slavery is difficult to detect.** The reputational risk of modern slavery, and the difficulty of detecting it leads to a reluctance by companies to detect and disclose instances of modern slavery. Investors' engagement with companies can also both seek to reduce the stigma of modern slavery risk and encourage companies to disclose cases they have identified, how they have remedied the situation and victims, and what measures are being implemented to avoid reoccurrence.
- **Remedy.** Providing survivors of slavery with access to remedy is a key pillar of the UN Guiding Principles on Business and Human Rights, but many victims receive little to no remediation for abuse.

An overview of resources schemes and trustees can use, or request that their appointed investment managers and consultants use, to begin to identify and address modern slavery can be found in Taskforce on Social Factors: Stewardship, investment and advice services.

3. Materiality assessment framework

This is an example approach to help evaluate investment portfolio exposure to social factor risks using a top-down review of the scheme's portfolio.

Starting with country level risks, the assessment then considers sectors, and then further narrows risks down to company-level analysis. The framework helps identify areas in the portfolio needing additional attention and where trustees can focus on monitoring of and meetings with asset managers.

The materiality assessment uses four key areas to understand social factors: direct workforce, supply chains, affected communities, and consumers or end users. Some social issues will apply to more than one category but many will be unique to each category.[14] Relevant data sources are listed to support the assessment. Trustees can also get data from data providers, investment consultants and advisers, and from asset managers. These factors and lists of resources in the materiality assessment framework are not exhaustive. For private assets, data will usually be with companies and asset managers rather than data providers or public reports.

Trustees can use the assessment framework at the frequency and level of detail that suits their scheme's level of knowledge, skills and resources, with the support of their investment consultants and advisers as needed.

<table>
<tr><th colspan="4">STEP 1: Country assessment</th></tr>
<tr><td colspan="4">Country level Data Sources: ILO Global Estimates of Modern Slavery; US Department of Labor ILAB Around the World | U.S. Department of Labor (dol.gov); Walk Free Global Slavery Index; Ranking Digital Rights' (RDR)); Human Rights Watch (for more sources see Taskforce for Social Factors: Directory of Data Sources</td></tr>
<tr><th colspan="4">STEP 2: Sector assessment</th></tr>
<tr><td colspan="4">Sector Level Data Sources: Producers of Cluster Munitions – Stop Explosive Investments; Access to Medicine Index; Regulatory judgements - GOV.UK (www.gov.uk); WBA Financials; World Benchmarking Alliance (WBA): Seafood; Sustainability Accounting Standards Board (SASB) Materiality Maps.</td></tr>
<tr><th colspan="4">STEP 3: Corporate assessment</th></tr>
<tr><th>Category 1: Workforce</th><th>Category 2: Supply chain workers</th><th>Category 3: Affected communities</th><th>Category 4: Consumers and end users</th></tr>
<tr><td>• Fair pay/living wage/pay gaps
• Workforce composition and Diversity, Equity & Inclusion
• Collective bargaining agreements
• Mortality/ Injury data
• Employee engagement
• Modern slavery</td><td>• Modern slavery
• Health and safety
• Social protections
• Fair pay/living wage/pay gaps
• Supply chain mapping</td><td>• Bribery and corruption
• Collaboration and community engagement
• policies
• Water/land related issues
• Harm to livelihoods
• Violence against human rights defenders</td><td>• Data privacy
• Product quality and safety
• Ethical marketing
• Accessibility of products
• Cybersecurity / IA policies</td></tr>
<tr><th colspan="4">Sources</th></tr>
<tr><td>• WBA
• The Times Top 50 Employers for Women
• Racial Justice Scorecard
• CCLA Mental Health Benchmark
• AsYouSow – 100 Most Overpaid CEOs
• Fair Reward Framework (launching Dec 2023)</td><td>• WBA
• Know the Chain Benchmark
• International unions reports
• Good Business Pays - Late and Slow Payers List</td><td>• WBA
• NGO reports from e.g. Oxfam, Global Witness,
• Human Rights Watch, etc.
• Business and Human Rights Resource Centre
• 2022 Corruption Perceptions Index</td><td>• WBA
• Access to Medicine benchmark
• Access to Nutrition benchmark
• Ranking Digital Rights' (RDR) Corporate
• Accountability Index
• GDPR Enforcement Tracker</td></tr>
<tr><th colspan="4">Broad ESG Data Providers (offer a range of country, sector and company level information)</th></tr>
<tr><th colspan="4">MSCI, ISS, Sustainalytics, S&P, RepRisk</th></tr>
<tr><td colspan="4">Companies' own reporting
e.g. their Annual Reports and Accounts, any standalone Sustainability or DEI reports.</td></tr>
</table>

14 The framework aligns with work of the International Financial Reporting Standards Foundation and the European Sustainability Reporting Standards' approach to social factor reporting.

4. Social factor data

This section discusses data trustees can use to manage social factors in investment.

We recognise that trustees will be unlikely to need to understand social data in depth, however a basic understanding will be fundamental to ensure that trustees can appropriately engage with – and hold to account – their asset managers, investment and actuarial consultants on how best to consider material social risks.

Modelling, data and metrics

The economy-wide nature of many systemic social risks means that these can be hard to quantify and can struggle to fit naturally into investor analysis models, although there are efforts underway to model the effects of social risks and in particular, social tipping points.[15] The most widespread approach of pension scheme investment strategies currently is based on asset and liability modelling, with the process focussing on the more 'traditional' factors to determine financial materiality and the expected outcomes of a decision. Systemic issues, and a lot of social factors in particular, do not lend themselves to straightforward modelling that factors like volatility and expected returns enjoy. There are models to show the impacts on a portfolio from an interest rate or inflation change, for example, but not for the impact on employees of investee companies not earning a real living wage.[7]

The impact of social factors, such as the living wage, is no less real: decreasing employees' wellbeing and satisfaction combined with widening inequalities and further stratification in society can cause a fall in corporate profitability as consumers reduce purchasing, and so slowing economic growth. But it is, thus far, impossible to model. However, the fact that we cannot start to put numbers on these real risks does not mean we should simply ignore their reality. As owners of capital and with responsibilities to members and beneficiaries, many of whom will be low-paid employees of UK companies, managers of pension schemes should consider those social issues which they believe will most materially impact financial outcomes and savers' returns.

To substitute for the absence of these modelled numbers we might seek to apply approaches such as scenario analysis and stress testing, with work on social tipping points a growing area of research[9]. Alternatively, perhaps we need simply to accept that qualitative assessments of systemic risks would serve as strong a justification for action as a basis-point modelled difference in expected returns.

There are, however, a multitude of data sources, frameworks, benchmarks, portals, platforms and initiatives that can support understanding and evaluation of social factors from an investment perspective. In the majority of cases, for data to be useful, if has to be analysed – usually by the investment manager. Understanding which issues are important to an investor through a materiality and saliency mapping exercise will provide a starting point for individual topic analysis. This can provide a framework for understanding the relevance of social factors on financial returns and their impact on people.

Social factor metrics

Measurement, which is so important in identifying problems, opportunities and tracking change, presents specific challenges for social factors. Consistent measurement across different investments is difficult because there are many areas of social impact that lack commonality and can be hard to quantify and compare (for example, there is no single measure like carbon dioxide equivalent (CO2E) that is used for understanding carbon emissions and climate impact). Currently, the 17 SDGs are the most commonly used impact performance measurement tool, with investors looking at impact to one or more of the goals, like promoting inclusive economic growth or gender equality.

Some metrics relevant to social issues could be standardised and compared across investment portfolios if they were disclosed consistently and regularly. These include:

- number of full-time equivalent employee roles [total]; proportion of those who are paid a living wage [%]; employee turnover [mean and median]; proportion of workforce on '0' hours contracts [%].
- gender pay gap data [mean and median];
- ethnic pay gap data [mean and median]
- accident incidence rate [mean and median];
- fatality incidence rate [mean and median]
- maximum supplier payment term [mean and median];
- frequency with which those terms are exceeded [mean and median

Aggregated statistics could be supplemented by red flags regarding issues such as the absence of policies on modern slavery, and failure to recognise trade unions. If this data can be captured consistently and with confidence, the amount of investments, or proportion of total assets, subject to such red flags could be aggregated across funds and so be assessed by pension trustees. This will allow for poor performance to be recognised and potentially addressed.

15 A social tipping point is a point in time when a group—or many group members—rapidly and dramatically changes its behaviour by widely adopting a previously rare or proscribed practice. Examples include extending the right to vote in some places to include women, black and Indigenous peoples throughout the 20th Century

There are many data providers. Some provide free data which is open to source, while others will charge. It is important to understand the lens applied by each data supplier: free is not necessarily better and commercial datasets are not necessarily comprehensive. Some providers can also provide a rating or score for a company's performance either across the spectrum of ESG issues or on a single issue. These ratings will vary based on a number of factors including:

- the underlying weightings given to specific data points in the model
- the ratings framework aims to assess different things (eg, impact vs management of risk/opportunities)
- providers using different sets of attributes
- providers using different data points to assess the same attribute.

ISSB Sustainability Reporting Standards – global reporting standardisation

In June 2023, the International Sustainability Standards Board (ISSB) released its first two standards: IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information and IFRS S2 Climate- related Disclosures. ISSB standards aim to act as a comprehensive global baseline of sustainability-related disclosure by companies. ISSB's potential areas for research, which may lead to future standard-setting, include human rights issues and human capital.

The UK Government has indicated support for ISSB and its standards and is assessing whether and how the organisation's standards should become the UK benchmark. This would be unlikely to occur before 2025. Other countries will go through their own assessments.

ISSB consulted in 2023 on an agenda for future work (on biodiversity and human rights and human capital). ISSB's IFRS S1 already requires disclosure of material information about all sustainability-related risks and opportunities that could reasonably be expected to affect the entity's cash flows, its access to finance or its cost of capital over the short, medium or long term. And IFRS S1 sets out relevant sources of guidance.

However, developing additional IFRS Sustainability Disclosure Standards to consider the specific matters related to each key category of sustainability-related risks and opportunities will assist entities in making their disclosures.

The TSF supports an agenda that advances of the development of thematic standards on social factors, leveraging existing advanced thinking and best practice.

Social factors are often combined with environmental and governance factors into a single ESG score, and this score may be aggregated at fund level. These layers of aggregation can pose challenges, because:

a) poor performance in one area can be offset against good performance in another (e.g. good scoring on pay practices might cancel out poor human rights scores), and

b) if a significant concern only applies to one company that constitutes a small fraction of a fund, the overall assessment may be positive, while the impact on people and the investment risk from that company is not reduced or mitigated.

Asset managers may also have access to social data as part of reporting services. For example, the Investment Consultants Sustainability Working Group (ICSWG) developed a standard set of ESG metrics that investment managers should be able to report to clients for listed equity and credit mandates, including metrics on gender board diversity, labour and human rights violations.

Social factor data, like any other investment decision data, has to be of good quality to be useful for investors. Trustees should consider – or ask their investment consultants to help them ask their asset managers to consider:

- How accurate is the data?
- Can the data be independently and objectively verified?
- How frequently is it updated?
- What is missing or how is it different between asset types?
- How is it reviewed – by experts or junior staff?
- Who controls the production of the data? Is it objective or subjective?
- Can the data be easily incorporated into larger data sets? To be more helpful, data can be arranged and manipulated into decision-making friendly information, which leads decisionmakers to develop deep knowledge of an issue, leading eventually to insights. For useful data resources that are available to trustees at the time of publication, see Taskforce on Social Factors: Directory of Data Sources.