Final Report | March 2024

Considering Social Factors in Pension Scheme Investments:

Recommendations to improve the integration of social factors

Taskforce on Social Factors: Recommendations to improve the integration of social factors in pension scheme investment

Taskforce on Social Factors: Recommendations to improve the integration of social factors in pension scheme investment Pension schemes operate within a financial and regulatory ecosystem, with many stakeholders who can, and should, play a part in addressing social factors in pension investments. There are a number of opportunities for improvement of social factor integration throughout the pension and investment industry.

While the DWP, which convened the TSF, does not have powers over some of the targets of these recommendations, the Taskforce have set out what good looks like to improve social factor integration into investment strategies and stewardship – to help develop strong data flows, good social factor frameworks, robust disclosures and supportive regulations, working together to improve practices on social factors in the economy.

Pension Trustees

Most pension trustees are already required by law to develop and maintain a statement of investment principles (SIP), which must cover, amongst other things, their policies in relation to financially material considerations, including social factors which the trustees consider are financially material. This can be a standalone social factors policy (as part of a suite of individual thematic policies) or form part of an ESG policy.

The taskforce recommends:

1. Trustees to have a good understanding of the way their investment consultants approach social factors (and wider ESG factors) and set them objectives related to these factors. To help facilitate better alignment and understanding, example questions to ask investment consultants are in Taskforce on Social Factors: Stewardship, investment and advice services.
2. When appointing asset managers, trustees to ensure the manager considers social factors, and that these are integrated into the investment strategy and stewardship of investments. Examples of Request for Proposal (RFP) questions and mandate terms are in Taskforce on Social Factors: Stewardship, investment and advice services.
3. Trustees to make sure their asset managers have a strong engagement track record, appropriate exclusion policies and display responsible behaviour as businesses. Trustees should also ensure proxy voting policies of asset managers align with the trustees' policies and investment beliefs. Trustees should set clear expectations of managers on social factors, with a focus on desired outcomes.
4. Trustees to consider their own practices in relation to social considerations, including paying fair wages, inclusion and diversity, consultation with stakeholders, vetting of procurement/supply chain (including in relation to modern slavery).
5. Trustees to consider social impact investment opportunities where financial outcomes align with desired social outcomes.
6. Trustees to improve their understanding of key areas of social factors, like human rights and modern slavery.

Regulators

Regulators set expectations for desired behaviours and practices in the pensions and investment industries. Establishing this Taskforce, and the actions that have come out of it, is a good example of DWP prioritising social factors. Likewise, the FCA's proposals for sustainable disclosure requirements are a step towards enhancing consumer trust in sustainable investment products.

The taskforce recommends:

7. DWP to consider formally setting out expectations on addressing social factors for pension funds, to then be overseen by The Pensions Regulator.
8. FCA, to aid further progress, to consider setting out social factor reporting expectations by asset managers alongside those already required for environmental factors as in DP 21/4.
9. TPR and the DWP to reiterate their expectations for trustees' stewardship and engagement with companies on social factors, to continue to build momentum on the back of the work of this Taskforce. We welcome the FCA's focus on systemic stewardship in their DP 23/1 and welcome further alignment across the investment and pensions sectors.
10. TPR to consider ways to raise awareness of social issues among pension trustees to help them integrate these factors into their investments. TPR to consider doing this alongside their climate change strategy.
11. UK regulators to signpost the relevant learning materials developed by the Impact Investing Institute and its partners, to strengthen impact investing knowledge and adoption amongst trustees of pension schemes.
12. UK regulators to ensure interoperability of various taxonomies, standards and frameworks so the UK is aligned with other jurisdictions to support investors.

Government

UK Government need to consider ways to address social factor data availability and gaps.

The taskforce recommends:

13. Government to continue facilitating a supportive policy environment for action on social (not just environmental and governance) issues and ensure implementation and effective enforcement of regulation.
14. Government to continue work on introducing enhanced economy-wide disclosures and encouraging global standards-setters, such as ISSB, to incorporate social factors. For example, making ethnicity pay gap reporting mandatory would provide a flow of information for investors. The Taskforce also supports developing a social taxonomy in addition to the work already undertaken on the UK green taxonomy.

15. Government to ensure interoperability of various taxonomies, standards and frameworks so the UK is aligned with other jurisdictions to support investors.
16. When requirements related to social factors are relaxed for various policy reasons, it is important that this is temporary and that the Government continues to enforce existing regulations to tackle social issues (for example, suspending gender pay gap reporting during the Covid pandemic).

Asset Managers

Asset managers need to be making continued progress on taking account of social issues in their investment strategies. This includes integrating social factors into active investment strategies, using exclusions selectively and considering optimised benchmark indices for passive strategies.

The taskforce recommends:

17. Asset managers to operate clearly articulated stewardship, engagement and voting policies covering social issues, resulting in considered, structured engagement activity. This includes appropriate escalation strategies, like co-filing relevant shareholder resolutions related to social factors.
18. Asset managers to be able to demonstrate that they have influenced social outcomes through transparent reporting on engagement, voting and investment outcomes, including any social investment metrics.
19. Asset managers to support clients with gap analysis on stewardship and voting policies and activity to help increase alignment and understanding between them.
20. Asset managers to actively participate in engagement collaborations, developing and inputting to public policy and best practice debates.
21. Asset managers to conduct due diligence on human rights and modern slavery in their investment portfolio and disclose the results.
22. Asset managers to undertake continuous learning and upskilling to effectively manage social factors for their clients. It is particularly important that knowledge and skills are developed for use in the day-to-day work of all asset managers to maximise adoption of responsible investment practices across the firm's portfolios, rather than siloed in an 'ESG team' or similar.

Data providers and proxy voting agencies

Data providers have an important role to play in gathering and improving the quality of corporate disclosures on social factors. This goes beyond a norms-based breach or minimum safeguard approach to assess quality of disclosures as well.

The taskforce recommends:

23. Where scoring methodologies focus on controversies or disclosures, data providers to consider strong mark-downs of ratings for absence of key data to encourage enhanced disclosures from issuers of investments.
24. ESG data and service providers need to work closely with investors and other groups to find common ground on methodologies and metrics for social factors.
25. Data providers to play a more active role in channelling market demand for data from investors and become more active in their engagement with corporates, given their access.
26. Service providers to consider how to scale up data on business' supply chains provided to investors, beyond those in 'high-risk' sectors.
27. Proxy voting advisers to include more social factors (for example human rights) in their analysis and help identify laggards.

Investment Consultants

Investment consultants are a key adviser for many trustees and need to integrate social factor considerations into their investment advice. They can also support managers of pension schemes with materiality mapping of their investment portfolios and help them develop strong stewardship and voting policies.

The taskforce recommends:

28. Advice on social factors to be included in investment and stewardship advice as a standard part of the services provided to pension trustees without added cost and help trustees integrate these factors into asset manager selection. Deep dive analysis and reporting would be project-based and we would expect these to be charged for separately, as opposed to, for example, strategy review work which shouldn't have social factor inclusion into assessing portfolio risks and returns as optional.
29. Investment consultants to support pension trustees to integrate social factors into asset manager selection and monitoring, both at strategy and at firm level, using tools like the Asset Owners Diversity Charter questionnaire14.
30. Investment consultants to undertake continuous learning and upskilling to effectively deliver advice on social factors for their clients. It is particularly important that knowledge and skills are developed for use in the day-to-day work of all consultants to maximise adoption of responsible investment practices across the consulting firm's client base, rather than siloed in an 'ESG team' or similar.

Legal advisers

Legal advisers play an important role when it comes to pension schemes adopting more focussed ESG practices, including considering social factors. Trustees receiving legal advice confirming that ESG integration is in line with fiduciary duties (and the absence of considering ESG factors constituting a breach of their duties) helps to establish more robust investment practices in the UK pensions industry. It is important that advice continues to support trustees as they progress their ESG implementation in line with their legal duties, with reference to developing market practices, products, regulations and member expectations.

The taskforce recommends:

31. Legal advisers to stay up to date with developments to enable them to support trustees integrating social factors into investments.
32. Legal advisers to adequately equip themselves to support trustees looking to invest in social impact investment strategies.
33. Legal advisers to offer more support to stewardship teams, helping them carry out effective stewardship across multiple jurisdictions. This can be complicated given differences in anti-trust laws, shareholder rights and voting rules, to name but a few. Law firms can also join investor collaborations and collective engagement initiatives to help the industry work towards the shared goal of improving the sustainability and resilience of the global economy.

Civil society/Non-governmental organisations (NGOs)

As institutions and individuals with subject matter expertise, civil society represents an important collaborative partner to support effective stewardship through subject matter expertise and development of relevant social related data, analysis,

and insight. Civil society can play an important advocacy role, highlighting gaps not covered by traditional ESG analysis.

NGOs can provide guidance on best practice, horizon scanning, and evolving expectations on social factors.

The taskforce recommends:

34. Civil society (including people affected by social factors, indigenous communities and unions) and NGOs need to be part of the conversation, helping trustees of pension funds to understand the impacts of their investments in a way that is distinct from but complementary to corporate reporting and ESG data.
35. Civil society and NGOs to help develop outcomes-based reporting standards for companies on social factors. Data and reporting available from companies, when available, relates to a great extent to labour or human rights-related policies rather than the implementation and outcomes of the policies as a measure of risk to investors and people. Encouraging wider and more effective disclosures from companies requires improved reporting standards.
36. Pension schemes, NGOs and academics to form productive collaborations to develop and improve consideration of social factors in investment.

Businesses and employers

Businesses already have obligations relating to social factors, with some key requirements stemming from the UN Global Compact and the UN Guiding Principles on Business and Human Rights.

The taskforce recommends:

37. Company boards to establish appropriate policies, due diligence and access to remedy processes to deal with human rights issues which may arise in connection to their workforce and operations. Companies should also proactively identify modern slavery risks and incidences across their supply chains and report on any actions taken to mitigate them.
38. Companies to provide clear, full and timely disclosures on social factors to support investors, who rely heavily on data provided by businesses to assess social risks and opportunities. In addition to existing mandatory reporting, like the gender pay gap, businesses should voluntarily report on:

- ethnicity pay gaps;
- internal pay ratios;
- human capital management key performance indicators, including composition of the workforce, workplace safety and standards, employee turnover, absenteeism rates, skills and capabilities, employee engagement, gender diversity and other useful indicators that help investors assess companies' human capital management practices.

And companies to engage with leading reporting initiatives like the Workforce Disclosure Initiative.