PENSIONS AND
LIFETIME SAVINGS
ASSOCIATION

# CONSIDERATION OF SOCIAL RISKS AND OPPORTUNITIES BY OCCUPATIONAL PENSION SCHEMES

JUNE 2021

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## EXECUTIVE SUMMARY

- It's clear that pension schemes have always been mindful of the impact of social factors, but the events of the past year – the impact of COVID 19 on our working lives and a growing awareness of issues such as diversity and inequality – have resulted in a greater focus on them by schemes. Climate considerations have dominated in recent years, but 75% of respondents of a PLSA survey plan to review their social policy within the coming year.[1]

- Of those listed, modern slavery, health and safety in supply chains, workforce conditions, and remuneration practices top the list of issues schemes are concerned about. The PLSA's Worth of the Workforce[2] discussion paper has also identified areas such as gender diversity, employment type, staff turnover, investment in training and development, pay ratios and employee engagement as being especially important to schemes.

- High-quality and relevant data on company social and stakeholder related practices remains a significant barrier – two thirds of schemes do not feel that they have enough. Having previously reported on this in our Worth of the Workforce and Hidden Talent[3] reports, the PLSA is launching another research project on this in 2021.

- Social factors are often more complex than climate ones, which results in the issue being more difficult to monitor in terms of impact.  Meaningful reporting has to provide both data and narrative for investors to be in a position to make informed decisions.  We should be cautious about any expectation that social factors can be treated the same as environmental factor reporting.

- Pooled fund vehicles continue to be a barrier to direct stewardship on these matters, particularly for smaller schemes.

- Around half of schemes have actively undertaken engagement or stewardship on social factors in the past 5 years. There is high levels of confidence that they have positively influenced situations by doing so.

[1] Based on survey of PLSA members, May-Jun 2021. Respondents of the survey reflect views from across our membership, which include DC, Master Trust and DB Schemes, as well as funds from the LGPS. However the figures cannot be used to extrapolate to the whole of the sector at this time Figure likely to reflect some bias towards larger schemes.

[2] https://www.plsa.co.uk/Policy-and-Research/Document-library/Where-is-the-workforce-in-corporate-reporting-An-NAPF-discussion-paper

[3] https://www.plsa.co.uk/Policy-and-Research/Document-library/Hidden-Talent-2-Has-workforce-reporting-improved

## ABOUT THE PLSA

Our mission is to help everyone achieve a better income in retirement. We work to get more people and money into retirement savings, to get more value out of those savings and to build the confidence and understanding of savers.

We represent the defined benefit, defined contribution, master trust and local authority pension schemes that together provide a retirement income to 20 million savers in the UK and invest £1 trillion in the UK and abroad. Our members also include asset managers, consultants, law firms, fintechs and others who play an influential role in the governance, investment, administration and management of people's financial futures.

**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?**

In a survey of our members in May 2021, almost half (42%) advised us that they have a policy that specifically covers financially material social factors, and the same number have a stewardship policy that covers social factors specifically. One in five schemes (19%) discuss social factors separately to other ESG factors. We appreciate, again, that these figures do not necessarily give a sector wide position, but nevertheless, we believe it shows it increasing importance of these matters for schemes.

We believe this demonstrates that larger schemes are more likely to have their own specific policy (and voting policies) on social (and other) factors, whereas smaller schemes tend to make use of voting and governance guidelines from organisations such as the PLSA[4], the Investment Association[5], AMNT[6] and others. The PLSA's 2021 Corporate Governance and Voting Guidelines, for example, include voting recommendations on Remuneration, Composition and Evaluation, which all could be considered 'social' in nature.

It is clearly the case that the climate factors have taken prominence in recent years, both in light of increased regulatory scrutiny and growing awareness within society. However, social factors have always been prominent in the minds of pension schemes trustees – a number of schemes have been participants in the Workforce Disclosure Initiative for a number of years, for example[7]. We believe that social factors are growing in prominence in consideration, particularly given the increased awareness of workforce matters since the COVID 19 emergency started. In our survey we also asked schemes when they next planned to review their social policy. 75% of those who responded plan to within the next year, with almost a third (30%) planning on doing so within the next six months. We would suggest, therefore, that the percentage of schemes with a specific policy will continue to grow in the coming months and years.

Members told us that, though the debate on these issues is not as prominent, nor well developed, as that on climate, increased public activism – particularly in areas such as diversity and modern slavery - means that it is on the agenda of trustees.

[4] https://www.plsa.co.uk/Policy-and-Research/Stewardship/Corporate-Governance-Policy-Voting-Guidelines

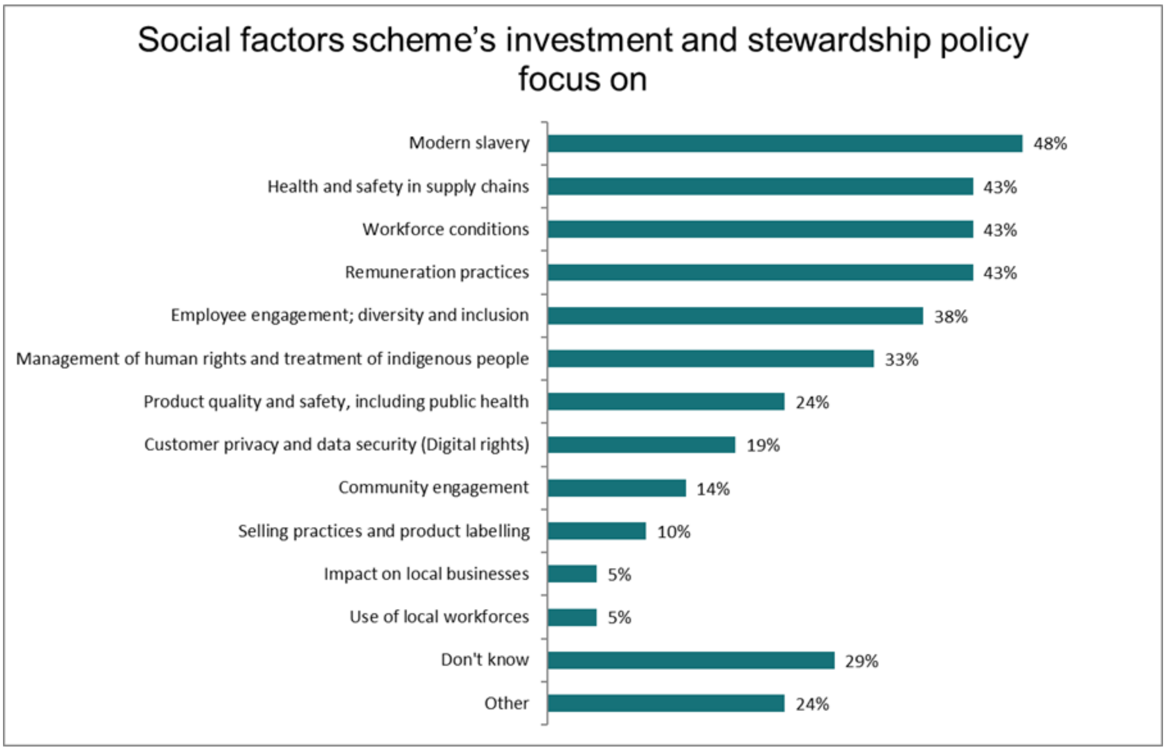
[5] https://www.theia.org/campaigns/stewardship-and-corporate-governance#

[6] http://redlinevoting.org/

[7] https://shareaction.org/workforce-disclosure-initiative/

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?**

The areas our members are most focused on are modern slavery (48% of those surveyed), health and safety in supply chains (43%), workforce conditions (43%) remuneration practices (43%). More than a third also focus on employee engagement, diversity and inclusion (38%) and management of human rights and treatment of indigenous people (33%)




You may also wish to refer to the PLSA's Worth of the Workforce, and Hidden Talent Work, for which we worked with funds to establish which metrics were valuable to trustees, and analysed to what extent they are reported against by FTSE companies. Areas highlighted to us as important included Workforce Composition (including use of agency workers and pay ratios), by 94% of schemes; Workforce Stability (including staff turnover and workplace accidents; by 100% of schemes asked; Skills and Capabilities, by 100% of schemes; and Workforce Engagement, by 98% of schemes[8].

In terms of reasoning, we believe that priority is given to financial materiality considerations – the issues at the top of the list are those which carry a risk of criminal penalties and therefore pose much clearer financial risks to an investment. However, we believe that interest in social topics

[8] https://www.plsa.co.uk/Portals/0/Documents/Policy-Documents/2017/7160%20Hidden%20Talents%20research%20report%20v4.pdf

may have evolved since the last round of Hidden Talent work, and broader social impact is subject to more scrutiny, and that there is now a wider focus by trustees. We therefore plan to re-run this research in 2021, including the metrics and the extent to which they are reported against by the largest companies. We will of course be happy to share these findings.

**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?**

The main tools that members use (and find useful) are the Financial Reporting Council Stewardship Code, the Workforce Disclosure Initiative and the PLSA Worth of the Workforce toolkit.

As set out above, our members feel that one of the biggest barriers to effective scrutiny and stewardship is the lack of data available to them. In our survey, more than two-thirds (68%) said they know very little about how companies perform on social issues. This reflects the findings of our Worth of the Workforce research, referred to above. When we revisited the research in 2019[9], we found there had been improvements in many areas, including reporting on supply chain ethics, and levels of employee ownerships (increasing from 5% to 18%). However, we also found that the reporting remained frustratingly low on others, including workforce ethnicity pay gap (3%), and discussion of mental health (3%). This reflects findings of the Financial Reporting Council on social issues[10].

In many ways, the challenge is similar to those identified in relation to the climate debate - albeit the mandatory expectations on companies are not as comprehensive (aside from some limited pay gap requirements, there is nothing as comprehensive as the forthcoming TCFD regulations in the pipeline). Our members also felt that the situation is far more complex than the climate one, in that the ‘S’ in ESG covers a much wider range of factors, there is less agreement on which are important and, in many cases, not always clear what is and is not considered ‘good behaviour’.

For example, one of our members highlighted that they have an established list of countries that they do not invest in due to their own concerns about human rights violations within those countries, based on information from independent and respected sources. They believe this is in keeping with the preferences of beneficiaries of the scheme. However, they flagged that the Government continues to participate in initiatives to encourage more trade with some of these countries, demonstrating the complexity of the situation for investors seeking to do ‘the right thing’. Similarly, technology companies – which the UK Government has promoted investment in via the response to the recent review of UK premium listings – face considerable scrutiny in relation to workers’ rights, privacy and social matters.

There is a clear appetite for pension schemes to continue to engage with the issues they consider important, and we suspect that their influence on these issues will continue to grow. However, there is a systemic global issue with the way that companies report, and we’d welcome consideration by Governments as to how they can help address this. This is essential for pension schemes to meet their regulatory requirements not only in relation to social factors, but climate and a range of other factors.

9 https://www.plsa.co.uk/Policy-and-Research/Document-library/Hidden-Talent-2-Has-workforce-reporting-improved

10 https://www.frc.org.uk/getattachment/59871f9b-df44-4af4-ba1c-260e45b2aa3b/LAB-Workforce-v8.pdf

We would also flag the challenges in interpreting data on global investment. For example, an area of increased focus has rightly been diversity. However, for investments made in companies that have a global workforce or, in particular, a global supply chain, it would quite clearly be inappropriate to apply UK standards - established to meet the needs of a developed, relatively diverse country - across the board. We are also conscious that diversity data reporting relies on the workforce's willingness to provide such information as well as the regulatory regime applied (ethnic reporting is not allowed in certain countries). It is therefore important that companies provide narrative reporting to enable effective scrutiny.

We believe that these issues are extremely complex and do not believe that the principles of the response to climate change – where the Government has rightly taken ambitious steps to require comprehensive reporting in relation to specific metrics – can simply be applied. We believe that focus should be on the information that is made available to investors, including by asset managers and underlying investee companies.

**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?**

As a trade association, we have worked with funds to establish metrics and toolkits to enable them to monitor which issues are seen as a priority, and to have the tools to engage with companies on[11]. This has largely been useful to members who recognise not only their own role in stewardship of individual investments, but also to raise the profile of the issue, and contribute towards better reporting across the board. We also publish annual voting guidelines[12], to enable investors to understand recent trends and ensure their voting preferences reflect them, and a Vote Reporting Template[13], to help schemes communicate with asset managers on how their beliefs are being implemented.

This year, in partnership with the CIPD, High Pay Centre, and RPMI Railpen, we plan to undertake refreshed 'Worth of the Workforce' research, which will establish which metrics are most valuable to pension schemes in undertaking scrutiny and stewardship on workforce issues, and establish to what extent they are reported by FTSE listed companies. We hope to publish the findings of this in the Autumn, and that the project will be a valuable tool both to understand the evolving trends on areas of scrutiny, and to raise awareness within companies on the need to report.

**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?**

We believe that it is important that asset managers are in a position to provide the necessary data on material social factors, and be in a position to act on the investment preferences of asset owners, as set out and agreed in mandates. This should include assessing social factors, reporting on them to clients, and engaging in stewardship activity where relevant and necessary. As noted above, however, better reporting by investee companies is fundamental to increased consideration of social factors.

[11] https://www.plsa.co.uk/portals/0/Documents/0591-Understanding-the-worth-of-the-workforce-a-stewardship-toolkit-for-pension-funds.pdf

[12] https://www.plsa.co.uk/Policy-and-Research/Stewardship/Corporate-Governance-Policy-Voting-Guidelines

[13] https://www.plsa.co.uk/Policy-and-Research-Document-library-Implementation-Statement-guidance-for-trustees#_ga=2.59031469.1696076347.1600689293-1199829888.1568625039

At the time of writing, the PLSA and the Investment Association are jointly chairing a working group that is looking at solutions focused on ensuring effective stewardship throughout the investment chain, including the role investments managers should play in delivering clients' stewardship priorities, the flow of information, the role of asset owners in terms of manager selection and ongoing performance. We are hopeful that this group will be in a position to produce practical resources to assist schemes in this area.

As has been much discussed in relation to climate change, the challenges presented by pension schemes being invested primary in pooled funds is similarly problematic in relation to social factors – ie, the lack of direct voting makes it more difficult to monitor the impact of stewardship. We are aware that this is something under active consideration by the Government's task force, and would be happy to contribute where appropriate.

**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?**

One in five (20%) of our members surveyed have undertaken stewardship up to 20 times in the past 5 years, while a quarter have undertaken stewardship with an investee company on a social factor more than 30 times (24%). We believe that this indicates the largest schemes are more likely to carry out direct stewardship, due to resources and segregated mandates. We should have a better picture of this once the first round of Implementation Statements are available.

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

Of those who had, almost three-quarters feel that the stewardship activities have had at least a fair amount of impact (73%), with one in ten saying they have had a great deal of impact (9%). However, one five say that it has only had a little impact (18%), possibly because of the length of time it can take to affect a significant change of direction, or because of resistance despite significant pressure from minority shareholders. It was highlighted that a one of the key factors was critical mass of engagement, and so success is tied to more investors being in a position to carry out engagement.

Examples of positive engagement highlighted to us include: an agreement by Rio Tinto to engage more effectively with local communities in the wake of two culturally significant sites being destroyed in Australia, and removal of the CEO for failure to implement their own policies; checks that sufficient controls were in place to prevent the exploitation, and ensure safety of, workers in a Singaporean corporation; engagement around COVID practices within UK firms within the past year. Some pension schemes highlighted examples of them withdrawing investment in areas where mitigation had not been possible.

**(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?**

As already set out in previous answers we believe, generally, that a lack of data and information, supply chain difficulties, and a lack of influence in pooled fund vehicles, can all be factors in schemes feeling unable to influence social issues. The impact will depend on the size, and resources, of the scheme. We would generally like to see faster and more consistent policy interventions from Governments and bodies on these matters, and hope the UK Government will look at what influence it can bring to this.

In addition, members also flagged the challenges in tracking stakeholder expectations on these matters, for example, employees of companies entered into work place pension arrangements on their behalf.

One member scheme noted that they monitor disclosures by the scheme sponsor in line with their belief that ESG forms part of covenant risk. This has been raised but the requested data has never been provided, despite it being retained for five years, and is referred to in promotional materials. This is in keeping with evidence from elsewhere suggesting 85% companies failed to respond to stakeholder requests for workforce data[14].

**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?**

This isn't something we have gathered research on, though we are aware that some pension schemes have directed investment towards social impact projects, such as social housing and education, and there are some funds focused on social impact investment opportunities, including in emerging markets. Allocations tend to be small, perhaps because of a lack 'scale' projects, and of expertise and oversight in these areas.

[14] https://shareaction.org/companies-show-lack-of-transparency-on-vulnerable-workers-amid-covid-19-crisis/

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