THE SOCIETY OF PENSION PROFESSIONALS
making pensions work

By email: pensions.governance@dwp.gov.uk

For the attention of Emma Walmsley, Department for Work and Pensions

11 June 2021

Dear Emma

SPP RESPONSE TO DWP CALL FOR EVIDENCE: CONSIDERATION OF SOCIAL RISKS AND OPPORTUNITIES BY OCCUPATIONAL PENSION SCHEMES

The Society of Pension Professionals welcomes the opportunity to respond to this consultation.

Executive Summary

As noted in the Ministerial foreword to this call for evidence, pension scheme trustees should be (and we believe are) aware of the significance of environmental, social and governance (ESG) factors to pensions. They are also cognisant of their duties in respect of ESG factors as well as their fiduciary responsibilities to members and beneficiaries.

We agree that ESG action has tended to focus on the 'E' part of ESG, in particular climate change. However, we believe it is incorrect to think that climate change has been the sole ESG consideration of pension trustees. Simply because trustees' social policies are not elaborated on in the Statement of Investment Principles (SIP) to the same extent that their environmental policies are, does not mean that social factors are ignored altogether.

It is possibly fair to say that social factors are less well understood and that more could be done to raise awareness and support the efforts of pension schemes to identify and quantify social risks and opportunities, which are arguably more complex, less well defined and therefore harder to measure than environmental factors. Furthermore, whilst companies have made considerable progress in terms of their environmental and governance disclosures, social factors have been slower to receive the same level of attention.

The SPP does not represent any specific interest group or constituency, which means that we view matters from a variety of perspectives. This is particularly relevant here, as the answers to some of the questions are entirely dependent on the perspective of the respondent and could be very different depending on whether it is a large pension scheme, small pension scheme, professional advisor or asset manager.

Detailed Response

Q1: 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?

In our experience schemes do consider *all* financially material factors, including social factors, but do not necessarily differentiate between ESG factors when describing their ESG policies in the SIP. As there are many financially material considerations for trustees to take into account when making investment decisions, not all of which are related to ESG issues, it could potentially be detrimental to investment performance to single out any particular one, such as social factors, for additional focus if that results in less attention being paid to others.

Q2. Does your scheme, or do schemes you advise, have (a) a stewardship policy and/or (b) a voting policy that specify covering social factors?

Smaller schemes, which often invest entirely in pooled funds, will not usually have a stewardship policy or a voting policy that covers social factors specifically. In such schemes, stewardship of the assets (including the exercising of voting and other rights attached to investments) is, ultimately, delegated to the scheme's investment manager(s). Given that smaller schemes are, by default, adopting the manager's policies in this regard they would typically consider these as part of the manager/fund selection process, albeit alongside a wide range of other factors. Where a manager's stewardship, voting and corporate governance are not consistent with the trustee's views then that may preclude that manager from being selected.

Some larger schemes that invest via segregated mandates may have stewardship policies and voting policies that specify social factors and whilst this will vary from scheme to scheme we expect that the majority won't have anything specific. As previously mentioned, not specifying social factors within a scheme policy document does not mean that they are not given due consideration when investment decisions are made.

Q3. 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 answers to these questions will be very scheme specific. However, in general, the social factors that schemes tend to focus on are human rights, working conditions and pay, persistent breaches of the UN Global Compact and controversial weapons, or an issue which is specific to the nature of the sponsoring employer's business.

We have seen a number of passive and index tracking funds embed certain ESG factors and even implement some exclusions, such as manufacturers of controversial weapons and perennial violators of the UN Global Compact, from their funds. Consequently, these exclusions will be adopted by all investors in the funds concerned, regardless of the policies of the trustees.

Q4. 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 UN Principles for Responsible Investment and the UN Sustainable Development Goals are useful when seeking to understand and evaluate social factors. However, company disclosures relating to social factors are often not as clear or comprehensive as their environmental disclosures and without the same widely accepted metrics, more difficult to measure.

Asset managers can often come up with a good narrative in respect of a particular stock but that is not necessarily helpful to trustees when trying to understand how the overall portfolio is positioned or how exposed it may be to social risks.

Q5. 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?

Most schemes, other than those that choose to make impact investments targeting certain social factors, ,e.g. in social housing, will typically consider the risks and opportunities associated with ESG more broadly, including social factors, when deciding what asset classes to invest in, how to access those asset classes and as part of the manager selection process. There are many risks that are, or could potentially be financially material, that trustees need to manage and isolating social factors from the other factors is not necessarily appropriate. Consideration of the social risks and opportunities associated with individual investments is usually delegated to the selected asset managers and the amount of time and effort spent by trustees to understand and manage such risks needs to be proportionate.

Q6. If this is delegated to asset managers, how do you ensure and monitor that they manage the risks and opportunities associated with social factors?

The investment and operational due diligence conducted before managers are selected should reveal how and to what extent ESG factors (including social factors) are embedded in a manager's investment process. Part of this assessment will include a review of their risk controls and systems, but this will not usually seek to isolate social factors or focus on them above any other factors. Once a mandate is awarded the ongoing monitoring of the manager's performance should reveal any deficiencies in the manager's risk controls. Investment consultants will typically play an important part in both the selection and ongoing monitoring of asset managers.

Q7(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?

Given the nature of SPP as a body representing a range of organisations, it is not appropriate to answer this question.

Q7(b). If yes, please provide details including why you felt this was necessary, what was done and the impact of your intervention.

See above

Q7(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?

See above

Q8. 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?

The range of investment vehicles and opportunities available to pension schemes is ever-growing. This includes those that offer direct and indirect exposure to companies solving social issues, which are potentially attractive as a diversifier away from other assets held within schemes. As ever, however, in their infancy such opportunities are typically most readily available to larger schemes, due to minimum investment limits and governance limits, for example. Such investments are often available in non-public markets, and therefore less liquid, which can also limit the scope for DC schemes to invest.

Yours sincerely

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Investment Committee, SPP

Fred Emden
Chief Executive, SPP

THE SOCIETY OF PENSION PROFESSIONALS (SPP)

SPP is the representative body for the wide range of providers of advice and services to pension schemes, trustees and employers. The breadth of our membership profile is a unique strength for the SPP and includes actuaries, lawyers, investment managers, administrators, professional trustees, covenant assessors, consultants and specialists providing a very wide range of services relating to pension arrangements.

We do not represent any particular type of pension provision nor any one interest-body or group. Our ethos is that better outcomes are achieved for all our stakeholders and pension scheme members when the regulatory framework is clear, practical to operate, and promotes value and trust.

Many thousands of individuals and pension funds use the services of one or more of the SPP's members, including the overwhelming majority of the 500 largest UK pension funds. The SPP's membership collectively employs some 15,000 people providing pension-related advice and services.