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For the attention of: Emma Walmsley

16th June 2021

Sent via email to pensions.governance@dwp.gov.uk

Response to *Consideration of social risks and opportunities by occupational pension schemes consultation*

I am writing to respond to your consultation *Consideration of social risks and opportunities by occupational pension schemes* on behalf of ShareAction, a registered charity established to promote transparency and responsible investment practices by pension funds and other institutional investors.[1] We are a member organisation and count amongst our members well-known NGOs and charitable foundations, as well as over 26,000 individual supporters. Among other activities, we work with the financial services sector to promote integration of sustainability factors in investment decisions, long-term stewardship of assets and the consideration of the view of clients, beneficiaries and pension scheme members.

This consultation is timely: For several years responsible investment has centred around integrating climate risk into investment decision making. Covid-19 has shone a spotlight on the financial materiality of “S” factors, however, and investors’ attention is beginning to turn towards broader sustainability factors. While ShareAction is not an institutional investor, our work with investors to promote responsible investment means we are well placed to comment on initiatives to help evaluate and integrate social factors into investment decision making. Our response therefore focuses on “**Question 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?***” and “**Question 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?**”

In particular we call on the Government to consider how the Occupational Pension Scheme Regulations (OPSR) could be improved by requiring schemes to highlight their ESG priorities, to take action to ensure relevant “S” data initiatives are adequately funded, to embed a social taxonomy in the UK regulatory framework and to accelerate work around investor due diligence. We also comment on the Just Transition and recommend a more joined-up approach to financial regulation by creating a policy environment that will enable investing in companies with a “place-based” focus in the real economy.

[1] https://shareaction.org/

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Question 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?

We will answer the second part of this question first and base it on our experience of working with and scrutinising the activity of institutional investors including occupational pension schemes.

Do you feel that [occupational pension schemes] have sufficient understanding of how companies perform on social issues?

As the call for evidence notes, consideration of ESG factors tends to be dominated by climate change, leading to an increased risk of reduced returns where other financially material factors have not been given sufficient attention. This is true for most institutional and retail investors, however for occupational pension schemes, which have a legal obligation to create and maintain a policy on all financially material ESG factors, failing to give proper consideration to relevant "S" factors has the additional impact of potentially leading to a breach of trustees' fiduciary duties. We therefore fully support the Government investigating what is happening in this area in order to ensure its crucial reforms to the investment regulations in 2018 are not undermined.

Recommendation:

- One action the Government could helpfully take to accelerate trustee thinking around "S" would be to require in regulations that schemes have to outline in their SIP three key ESG factors the scheme has decided to prioritise, with a minimum of one "S" issue.
- Trustees should be required to explain why they have chosen these ESG factors as being in the interests of their members. This will avoid situations in which trustees just pick the issues they find easiest.
- Schemes' implementation statements should also address how these priorities have been addressed in the previous 12 months. While guidance from TPR would be helpful in addition, changes by DWP to the Investment Regulations to mandate such considerations would be far more impactful and we would support DWP taking this approach.

Social factors are less well-understood – relative to climate change – and investors' approaches to integrating "S" vary significantly. In part this is a reflection of the extremely wide variety of social issues that investors might consider. ShareAction works with investors across three distinct "S" work streams: the promotion of "good work", investors' role in promoting public health, and workforce practice disclosures. One issue that remains consistent across all these programmes is that a lack of reliable and consistent data is a major obstacle for investors seeking to integrate social factors into their investment processes.[2] We echo the point made in The ESG Working Group report which highlights the relative shortage of company disclosures on social topics as a key barrier to proper integration of "S" factors.[3]

Recommendation: DWP should work with BEIS and the FRC to ensure that corporate reporting is adequate to enable pension schemes to meet their fiduciary duty.

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[2] Blackrock, *Global Sustainability Survey 2020*, available at https://www.blackrock.com/corporate/literature/publication/blackrock-sustainability-survey.pdf

[3] The ESG Working Group, *Amplifying the "S" in ESG: Investor Myth Buster*, available at http://esg.trust.org/application/velocity/_newgen/assets/InvestorMythBuster.pdf?v7

Which resources [might occupational pension schemes find] useful when seeking to understand and evaluate social factors either for your scheme or a scheme you advise?

ShareAction's Workforce Disclosure Initiative aims to improve corporate transparency and accountability on workforce issues and to provide companies and investors with comprehensive and comparable data.[4] The WDI investor coalition is made up of 53 institutions with $7.5trillion in assets under management. Its annual survey and engagement programme generates new data on workforce practices, enabling signatories to integrate into investment analysis and practical insights on how to address workforce issues. In 2020 141 of the world's largest listed companies disclosed to WDI across 20 countries and every economic sector. Disclosures represented over 12 million employees in companies' direct operations and many more in supply chains.

As issues such as work practices during the pandemic, CEO to median worker pay ratios, and diversity continue to rise up the agenda for companies, investors and policy makers, it is essential initiatives such as WDI continue to receive adequately funding. The Government is right to recognise the importance of "S" factors and the need for investors to integrate "S" data, but it also has a role to play in ensuring the infrastructure that enables responsible investment to take place is adequately resourced.

Recommendation: The Government provided seed funding to create the WDI but this has ceased since the closure of DFID. The Government should rebuild its support – including financial support- for innovation in company reporting and initiatives that are seeking to fill an identified gap to help investors understand S-related risks.

In addition to the Government ensuring data initiatives like WDI are properly funded, we see two key initiatives that would support investors to obtain and integrate relevant "S" data. The first, is a "social taxonomy". We welcomed the announcement by the Chancellor that the UK will follow the EU's lead by developing a green taxonomy, but the Commission has now taken steps towards the development of a social taxonomy as part of its Platform on Sustainable Finance and we anticipate the first draft report will be published this summer. The UK's own green taxonomy continues to progress, and we welcome the recent announcement of the Green Technical Advisory Group, but we think a sequenced approach to introducing these vital tools may be unnecessary.

Recommendation: The UK Government should send a strong policy signal that it intends to introduce a social taxonomy over the coming years. This is important for several reasons:

- A lack of definitions, a standardised classification system and poor quality data are major obstacles to investment in socially sustainable activities.
- To help trustees to meet their fiduciary duty to consider *all* financially material factors, and thus protects the integrity of the 2018 investment regulations.
- The transition to a net-zero economy will only be possible through the creation of good quality jobs, a social taxonomy will be essential for investment in the "just transition".
- The new Stewardship Code requires signatories to integrate ESG considerations into decision making, and that 'signatories must systematically integrate stewardship and

[4] For more info on the Workforce Disclosure Initiative please visit shareaction.org/workforce-disclosure-initiative/

investment, including material ESG issues, and climate change, to fulfil their responsibilities'.[5]
- The pandemic has shone a spotlight on companies' treatment of stakeholders and investors are waking up to the need to properly engage on "S" topics.[6]

While it is right the green taxonomy should be based on science, given the nature of "S" factors it would be impossible to mirror this in any social taxonomy. Instead, it should be based on the SDGs and other agreed-upon international frameworks with a focus on at least: Health and wellbeing, education, gender equality, good work and workforce practices, reduced inequalities, sustainable communities and human rights.

Recommendation: The second initiative key to facilitating "S" integration is the introduction of investor due diligence requirements into the UK's regulatory regime. This could be achieved in several ways, but the creation of a Council for Investor Due Diligence, as proposed in ShareAction's Responsible Investment Bill would be particularly effective and efficient.[7] Embedded within the work of the Council is the concept of double materiality. Requiring investors to think both about the impact of ESG factors on their investments, but also about the impact of their investments on the environment and society would send a strong signal that the finance sector cannot continue to operate as if in a vacuum and must account for its externalities. As universal owners, these externalities play out across portfolios and it is short-sighted for investors like pension schemes to ignore them. The need to focus on investment impacts is also aligned with other Government-backed reviews, including the recommendations contained within the Dasgupta Review.

The Government may first want to explore whether there are any types of investments or social risk factors that are "beyond the pale" and undermining other areas of policy, for example investments that are potentially in breach of the Modern Slavery Act or other international conventions to which the UK is a party.

The Just Transition

One vital area of responsible investment that has been less well understood is the link between action on climate change and wider social factors. This needs to be remedied so the Government's ongoing work to address climate change is supported by all stakeholders involved in the transition to a net-zero economy.

Pension schemes have a key role to play in considering the social impact of tackling climate change and the transition to a net zero economy: the just transition.[8] Investments in a wide range of assets means that the challenges of a just transition have material implications for pension schemes which are not only financial. A failure by investee companies to achieve a just transition

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[5] FRC, *The UK Stewardship Code 2020*, available at https://www.frc.org.uk/getattachment/5aae591d-d9d3-4cf4-814a-d14e156a1d87/Stewardship-Code_Final2.pdf

[6] Schroders, *Has Covid-19 changed the conversation around sustainable investing?,* available at https://www.schroders.com/en/insights/economics/has-covid-19-changed-the-conversation-around-sustainable-investing/

[7] ShareAction, *Responsible Investment Bill,* available at https://shareaction.org/policy-and-regulation/responsible-investment-bill/

[8] ShareAction has recently published a briefing on the just transition, setting out recommendations for policymakers to advance the just transition in the UK and globally.

carries reputational, legal and human capital risks which will ultimately impair scheme members' ability to live in a decarbonised, sustainable economy.

Question 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?

The impact of the low-carbon transition will vary across geographic regions and sectors. Investing in companies that solve social issues is key to ensuring that local communities and workers benefit from investments during the transition. However, current investing is not getting to the local level.

Local finance can be more efficient and cost effective, building on communities' own resources, and supporting local solutions that tackle challenges with greater local ownership.[9] This will ensure vulnerable communities and workers, as the most in need for resilient development interventions during the transition, fully benefit from climate adaptation and mitigation investments. However, only a small proportion of climate finance reaches the local level, and an even smaller share is channelled to community organisations or small businesses.[10] Scotland's Just Transition Commission also acknowledges that further steps need to be taken to help finance flow to community level projects that advance a just transition.[11]

One key barrier is that institutional investors predominantly want to invest at scale, in liquid assets that are easily realisable. It is much more straightforward to invest in public equities in the renewables sector (for example), than financing small-scale community energy projects which are less attractive.

Recommendation: We recommend that the Department for Work and Pensions work with other governmental departments to review how the UK can take a more joined-up approach to financial regulation by creating a policy environment that will enable investing in companies with a "place-based" focus in the real economy. This should build on the existing work by the UK Government looking at how to allow pension schemes more flexibility for illiquid investments.[12]

I hope our views are clear, but please do not hesitate to contact us at fergus.moffatt@shareaction.org if you have any questions.

Yours sincerely,

Fergus Moffatt and Vanessa Calvache
UK Policy Team
ShareAction

[9] IIED (2016). *Money where it matters*, pg.4. https://pubs.iied.org/sites/default/files/pdfs/migrate/17419IIED.pdf
[10] Ibid.
[11] Scottish Government (2021). *Just Transition Commission: A National Mission for a fairer, greener Scotland*, pg.69. https://www.gov.scot/publications/transition-commission-national-mission-fairer-greener-scotland/
[12] FT (2021). *UK pension schemes wary of push for 'illiquid' investments.* https://www.ft.com/content/16cd0908-529f-4414-8eb6-d943a8651e71