Response from the Pensions Policy Institute
June 2021

PENSIONS POLICY INSTITUTE

Consideration of social risks and opportunities by occupational pension schemes

1. Response

1.1 This is the **Pensions Policy Institute's (PPI)** submission to the Department for Work and Pensions' (DWP) consultation: *Consideration of social risks and opportunities by occupational pension schemes.*

1.2 The Pensions Policy Institute (PPI) promotes the study of pensions and other provision for retirement and old age. The PPI is unique as it is independent (no political bias or vested interest), focused and expert in the field, and takes a long-term perspective across all elements of the pension system. The PPI exists to contribute facts, analysis and commentary to help all commentators and decision-makers to take informed policy decisions on pensions and retirement provision.

1.3 This submission does not address all of the specific questions in the consultation, neither does it seek to make policy recommendations. Rather, the response points to the research that the PPI has conducted on ESG investment, and social factors particularly, over the last year.

1.4 This submission is drawn from PPI's **Engaging with ESG** research series, which can be found on the PPI's website:

Engaging with ESG: The story so far
https://www.pensionspolicyinstitute.org.uk/sponsor-research/research-reports/2020/2020-12-02-briefing-note-number-124-engaging-with-esg-the-story-so-far/

Engaging with ESG: Climate Change
https://www.pensionspolicyinstitute.org.uk/sponsor-research/research-reports/2021/2021-02-18-engaging-with-esg-climate-change/

Engaging with ESG: Environmental, Social and Governance Factors
https://www.pensionspolicyinstitute.org.uk/sponsor-research/research-reports/2021/2021-04-22-engaging-with-esg-environmental-social-and-governance-factors/

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2. Summary

2.1 In recent years focus on ESG considerations has grown rapidly, with many trustees and providers increasing their understanding and knowledge of this area, particularly driven by changes in regulation. These regulatory changes, as well as greater focus on ESG across the industry, mean that more schemes are engaging with ESG considerations – and to a greater extent. However, there is still work to be done before all schemes are meaningfully taking account of ESG risks in their investment strategies to ensure that their members are appropriately protected.

2.2 While focus on ESG risk factors continues to grow, some areas are less developed and can be more challenging to integrate effectively. For some time, much of the focus on ESG has been skewed towards climate change. This heavy focus on climate change among pension schemes, policymakers and society more broadly has, at times, left other ESG factors, especially those falling within the social area, overlooked. However, as ESG investment becomes an increasingly important component of investment considerations, focus on these other areas is also growing, as more and more schemes recognise the need to mitigate the associated risks.

2.3 Consideration of social factors is growing, a shift that has been accelerated and highlighted by the events of the last year. Many of the events of 2020 have brought social issues into greater focus, for example the current COVID-19 pandemic and equal rights campaigns such as the Black Lives Matter (BLM) movement. The COVID-19 pandemic has emphasised the importance of areas in health and labour practices that may previously been overlooked, while the BLM movement has shone a light on racial inequalities. Nearly two thirds (64%) of Principles for Responsible Investment (PRI) signatories surveyed in 2020 said that COVID-19 had highlighted some social issues that were not already a priority, including areas such as: occupational health and safety; social safety nets; worker protection; responsible purchasing practices and supply chain issues; diversity; and digital rights, including privacy.

2.4 These developments over the course of 2020 emphasised how rapidly focus on social issues can evolve and come to the fore, underscoring the importance of schemes being both proactive and flexible in their approach to social considerations, and ESG more broadly. Social risk factors can have a substantial impact on the sustainability of supply chains and the value of shares held by investors, and so present a material financial risk to schemes that do not appropriately take account of these risks.

2.5 The broader range of issues that fall under the social component of ESG considerations, along with the qualitative nature of social metrics, contributes to the difficulty of integrating social risks into pension schemes' investment strategies. While financial risk must be the main focus of pension schemes when integrating ESG factors into their investment strategies, the social investment sphere generally focuses not just on limiting potential damage but also on creating social benefit. This means that social factors can be more challenging to assess than environmental factors, which tend to focus on reducing harm, or governance, which tends to operate within existing legal or stewardship frameworks. A respondent to the Engaging with ESG Survey highlighted the existence of 'difficulties with measuring positive social impact'. Considering historical confusion about the extent to which ESG factors are financially material and a perceived conflation between ESG and ethics, the nature of social factors might make some investment decision makers more hesitant to engage where the financial materiality is less obvious than for environmental or governance factors.

2.6 Schemes in the Engaging with ESG Survey report that consistent and clear data on social factors is especially challenging to find. The broader scope, qualitative nature and difficulties associated with evaluating social risks and opportunities mean that developing an understanding of data around social factors, and how this relates to scheme investment decisions, is more challenging than for environmental and governance factors. One respondent to the survey, a Master Trust, highlighted that '[social] data quality is even poorer than for environmental data'; another, a DB scheme, said of ESG information more generally that 'sadly [there was] too much focus on environmental and not social'.

2.7 There can also be regional and cultural variance in the definitions and importance given to different social issues, which is less problematic for environmental and governance factors that tend to be more globally agreed upon. Because of the broad range of issues encompassed by the social area, there is also the potential for competing considerations, either within the social sphere or with other areas of ESG. Infrastructure projects, for example, may be socially beneficial but can be associated with risks in other areas of ESG, especially environmental or even other social considerations.

2.8 Attitudes on social issues are becoming increasingly important. Public attitudes towards social issues are shifting and more people are aware of and concerned about injustice and discrimination within society. However, many pension schemes do not monitor public movements and societal shifts, despite the impact they can have on companies in which they are invested. 61% of schemes in the PPI Engaging with ESG Survey[1] said that social or environmental movements had not affected their investment strategy. Both DB and DC schemes were among the 39% who said that their investment strategy had been affected by social or environmental movements, as well as both large and relatively small schemes. However, it is also worth considering that schemes that have delegated most or all of their investment to a provider or external asset manager may be unaware of the impact that environmental and social movements may have had on their investment strategy.

2.9 Member views may become more influential on scheme investment decisions in future, with three quarters (75%) of schemes in the Engaging with ESG Survey expecting this will happen. There is some evidence that a greater focus on ESG and responsible investment can increase member engagement with their pension, although instances of members directly engaging with their scheme on these issues remains relatively rare, largely due to low levels of engagement with pensions in general. Although climate change is an issue of great importance to some members, there is evidence that social issues are considered to be even more important by members on average. Collective movements such as Make My Money Matter aim to increase awareness among scheme members of the impact of their pension investments. Such movements aim to put pressure on those responsible for investing their savings to ensure that it is invested in ways that do not contradict their values and beliefs about ESG and responsible investment. While these collective movements do make reference to social risks, such as unsustainable supply chains, focus is still largely on climate change-related risks. However, member engagement may be motivated more by social concerns, especially where these are perceived to have a more immediate impact in members' own communities.

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[1] The PPI's Engaging with ESG Survey was carried out in November 2020. The survey sought to gather insight into the approaches being used by schemes in order to take into account ESG risks, and the challenges they have faced along the way. The survey was open to responses from both schemes and third parties involved in the investment process, such as consultants and asset managers. There were 62 responses in total, including 31 pension schemes, 48% of which were Defined Contribution and 52% Defined Benefit.

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About the Pensions Policy Institute.

We have been at the forefront of shaping evidence-based pensions policy for 20 years.

The PPI, established in 2001, is a not-for-profit educational research organisation, with no shareholders to satisfy– so our efforts are focussed on quality output rather than profit margins. We are devoted to improving retirement outcomes. We do this by being part of the policy debate and driving industry conversations through facts and evidence.

The retirement, pensions and later life landscapes are undergoing fast-paced changes brought about by legislation, technology, and the economy. Robust, independent analysis has never been more important to shape future policy decisions. The PPI gives you the power to influence the cutting-edge of policy making. Each research report combines experience with independence to deliver a robust and informative output, ultimately improving the retirement outcome for millions of savers.

Our Independence sets us apart – we do not lobby for any particular policy, cause or political party. We focus on the facts and evidence. Our work facilitates informed decision making by showing the likely outcomes of current policy and illuminating the trade-offs implicit in any new policy initiative.

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Our Vision:

Better informed policies and decisions that improve later life outcomes

We believe that better information and understanding will help lead to a better policy framework and a better provision of retirement income for all.

Our Mission:

To promote informed, evidence-based policies and decisions for financial provision in later life through independent research and analysis

We aim to be the authoritative voice on policy on pensions and the financial and economic provision in later life.