LCP's response to the Taskforce on Social Factor's Consultation on its draft guide

Issued on 1 December 2023

Who we are

LCP is a firm of financial, actuarial, and business consultants, specialising in pensions, investment, insurance, energy, health and business analytics. We have around 1,000 people in the UK, including over 170 partners and over 200 qualified actuaries.

The provision of actuarial, investment, covenant, governance, pensions administration, benefits advice, and directly related services, is our core business. About 80% of our work is advising trustees and employers on all aspects of their pension arrangements. The remaining 20% relates to investment consulting work for other asset owners, insurance consulting, energy, health and business analytics. LCP is authorised and regulated by the Financial Conduct Authority and is licensed by the Institute and Faculty of Actuaries in respect of a range of investment business activities.

Our specialist Investment and DC practices advise on over £330bn in assets, across around 500 clients. The clients we advise range in size from under £10m to tens of billions of pounds.

Executive summary

Firstly, we would like to thank all those who contributed to the draft guide – the time and effort they have devoted in helping the industry move this important area forward is very much appreciated.

We are supportive of the goal of the Taskforce on Social Factors and strongly agree that pension scheme trustees should consider social factors as part of their fiduciary duties. In particular, we are supportive of the focus on addressing social factors through the lens of systemic risk, encouraging pension scheme trustees to adopt a universal ownership mindset.

We have provided responses to the questions set out in the guide within this paper. We would like to highlight these high-level points:

- We believe that the guide is too long and detailed for most pension scheme trustees to properly engage with and so a large part of it is likely to be of direct use only to the very largest schemes. We have outlined in our detailed answers ways in which the guide could be amended so that it is more accessible for the majority of schemes. It may also be helpful to acknowledge the reality of different schemes, eg those close to buy out may focus less on certain aspects of social issues although we would still expect them to consider systemic risks.

- In our view, the three-level framework is a key part of the guide and would benefit by being given more prominence. We propose that some good practice items are moved to best practice to encourage more schemes to believe they can realistically aspire to good practice.

- Given the majority of schemes set stewardship priorities, this would be a useful starting point for taking action with respect to social factors and could be reflected in the guide.

- We believe it would be helpful to see more consideration of, and guidance on, how social factors could be considered as part of trustees' work on climate change. This is because it is a resource-effective way for pension scheme trustees to consider such factors in more depth than currently is the case, given most pension schemes are already addressing climate change through an environmental lens. Not only does this approach make good use of trustees' limited resource, social factors are in any case a really important part of climate change considerations. For example, if the costs of climate policies fall disproportionately on the poorest in society, they could cause social unrest and make a successful transition less likely. We would therefore encourage the guide to make the link between climate change and social considerations more explicit and urge pension scheme trustees to do the same.

- The guide focuses on modern slavery in particular, over and above other social factors. We would like it to be made clear in the guide why this theme has been selected.

We are pleased to respond to this consultation and look forward to the publication of the finalised guide.

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About Lane Clark & Peacock LLP

LCP’s response to the consultation questions

Q1: Do you agree the report will be helpful for pension scheme trustees to better understand social issues and the impetus to act on them?

The draft guide is very comprehensive and provides a good explanation of why social factors are financially material and, therefore, why acting to address them is in line with trustees’ fiduciary duty. We are particularly supportive of the inclusion of analysis as to how social factors relate to systemic risk and universal ownership.

We do note that the guide is very detailed and for many pension scheme trustees, this may be too much for them to properly engage with, particularly for a smaller pension scheme. We believe this could be addressed by the following:

- including an executive summary up front with a shorter, clear explanation of why social factors are financially material and with clearer signposting on where further detail can be found;
- including for each chapter a short opening summary setting out what the chapter covers;
- providing earlier signposting of the three-level approach for assessing social factors; and
- improving the formatting to make the information more user-friendly. The current format is very text-heavy and visually unappealing – it does not draw the reader in. We would recommend running the document through standard accessibility software and giving some thought to its layout and design.

Q2: For scheme trustees, does this report adequately address and provide a way forward for your scheme circumstances?

Since we are not pension scheme trustees, we have answered this question based on the insights gathered from advising a range of pension scheme trustees, including those of smaller schemes, who are less likely to respond themselves to this consultation.

We are supportive of the approach of having different levels of action for different schemes based on their size and governance budget. While the three levels of action approach is helpful, we believe improvements could be made, for example:

- signposting the three-level approach earlier and more prominently in the document;
- prioritising or highlighting which actions trustees should take first. Our view is that even the lowest ‘baseline’ approach will require more action than many scheme trustees are doing currently. We are comfortable with this gap at present, given that this can provide trustees with a target for the work they should be covering in addressing social factors. However, we believe prioritising the steps to take would make the guide more user-friendly for smaller schemes looking to take at least some action; and
- setting out the proposed actions for trustees at a high level earlier in the document, so it is easier for trustees to identify the relevant actions they could take and know where to start.

Q3: Do you see the proposed systematic materiality assessment framework for social factors as something you can practically implement in your portfolio?

We suggest that this framework is positioned as a tool that trustees can ask their investment managers to use, to evaluate their portfolio’s exposure to social factors and then report the results to the trustees. We would therefore recommend changing the emphasis to encourage trustee boards to use the outputs from applying the framework as a means of:

- identifying which mandates to prioritise in relation to social factors;
- engaging with their managers to understand their processes for addressing social factors; and
- exercising oversight of their managers’ management of exposure to social factors.

We would not expect trustees to use the framework themselves, although note that it may be used by the scheme's in-house team or advisers, particularly for larger schemes.

Given we expect only some schemes would use this framework, and mostly indirectly through their investment managers, we suggest this is better included as an appendix.

We view the framework as sensibly designed and as a useful aid for incorporating social factor considerations into pension schemes' investment processes. We note that some aspects of the framework may be difficult for schemes to implement in practice – for example, obtaining consistent country and sector portfolio exposure analysis where a scheme has multiple investment managers who use different country and sector classifications.

Q4: Do you believe the three-level framework for addressing social factors in pension portfolios provides useful developmental guidance?

Overall comments:

In our view, this framework is a key part of this guide and so should be more prominent. When using the framework, we expect that many trustee boards will turn straight to the category they view as most appropriate for their scheme, and will want a clear indication of which parts of the guide will help them undertake the actions needed to meet this categorisation.

We are supportive of the principle of a three-level framework as we believe this will help trustee boards identify what actions they should aim to take based on their scheme size and governance budget.

It may be helpful to outline which kind of schemes are expected to fall into what category, for example by considering their size, time horizon, segregated asset holdings, governance budget and views on responsible investment. Within each category it may also be helpful to prioritise actions or set out which actions are seen as being essential, and which as more aspirational. As currently drafted, we view the good practice and leading practice categories to be most relevant for very large, multi-billion pound schemes, with large governance budgets. It may therefore be appropriate to reduce the number of good practice items to make this category suitable for a wider range of schemes.

We provide the following comments on the actions set out under each of the three levels.

Baseline practice:

We view the baseline practice as being broadly appropriate for the "typical" pension scheme and expect that most schemes would adopt this approach. We have two comments related to schemes being expected to "*draw out specific themes that are key for the scheme*":

- We believe that most schemes could consider themselves to be universal owners, and so systemic social factors are likely to be those that are most relevant to them. It would be useful to include guidance on which factors are the most important systemically. The guide could present a list of social themes that are of the most systemic importance, so trustees can choose a subset of these to focus on, for example just transition as part of climate change.

- Outside of acknowledged systemic risks, we understand that different social themes may be appropriate for specific schemes depending on their investment arrangements, their sector and geographical exposures as well as their sponsor's view on social factors. However, we would expect holding-specific factors to be picked up by each scheme's asset managers.

Good practice:

- The guide sets an expectation for trustees to prioritise the most relevant social factors and highlight these as their stewardship priorities. In our experience, most schemes tend to have no more than three stewardship priorities, usually with one social factor. As a result, we think this is realistic for the largest schemes only.

- The guide also sets an expectation for schemes to receive reports on quantitative metrics. Though metrics can be helpful to monitor and assess risks and opportunities, we note that many social factors can be difficult to measure, at least currently – but this does not make them any less important. We have concerns that too much focus on quantitative metrics could encourage schemes to adopt social themes that are easier to measure, rather than the themes that are the most material, and for which their influence can be the greatest. We would recommend including in the guidance a reminder for trustees to focus on the most material factors rather than those that are the most straightforward to measure.

- The guide encourages scheme trustees to join the Occupational Pensions Stewardship Council. Given likely practical limitations on how many schemes can join this, it may not be feasible for all schemes that wish to fall under the good practice level to meet this recommendation. We note that a merger has been proposed between the Occupational Pensions Stewardship Council and UK Asset Owners Roundtable.

- It is recommended that schemes engage with their members to ascertain their views on social factors. We recommend clarifying how trustees might use this information, given our comments below (under "Additional detailed comments") about the Law Commission's two-step test. We believe it is primarily relevant for member communications, and the self-select range for DC schemes, so suggest that this is included under leading practice instead.

- We think the recommendation for schemes to consider joining collective stewardship initiatives should also be moved to leading practice since this is likely to be too advanced and require too much resource for the majority of schemes. Instead, good practice, or even baseline practice, could include encouragement for schemes' asset managers to sign up to these collective initiatives.

- Trustees are also encouraged to incorporate social factor considerations within their own operations. We question what size of operations is being considered here, as, besides the largest schemes with in-house teams, most schemes' operations will be limited to their trustee board and advisers. Our view is that that social factor considerations such as diversity, equity and inclusion (DEI) should be addressed as part of good board governance and procurement practices, rather than as a separate corporate social responsibility consideration for the trustee board.

- To the extent that there is an in-house team, we expect that other broader social considerations, from an operational perspective, are likely to be covered by the sponsor's own approach to social factors. It would be useful to understand what is expected for pension schemes with different operational structures under this recommendation.

Leading practice:

- Given the need for collective action to address the systemic risks associated with social factors, we suggest that the recommendation "*Trustees could also encourage other market participants to align and improve*" currently included under leading practice should be moved to good practice, replacing the word "*could*" with "*should*".

Q5: Do you agree with the resulting recommendations for the pensions ecosystem?

We provide our comments below on our views on each set of recommendations for different parties in the pensions ecosystem:

Pension Trustees

We are broadly comfortable with the recommendations set for pension scheme trustees, noting that many of these involve having oversight of the approach to social factors used by their asset managers and investment consultants, which we believe is appropriate.

There is a recommendation for trustees to consider social factors within their own operational practices. As we noted in our response to Q4, for most trustee boards, the main consideration will be the DEI of their own board, advisers and managers, which should be picked up as part of good governance considerations, rather than addressed as a separate social consideration. With the exception of the largest schemes that have in-house teams, most schemes will have a very small operational footprint.

We also note the recommendation that trustees should improve their understanding of key areas of social factors, "*like human rights and modern slavery*". As we stated in our response to Q4, we think the guide should more clearly set out which social factors are expected to be of the most systemic relevance to trustees. The guide should make it clear why these topics have been selected, and why the guide focuses on modern slavery in particular.

Regulators

We would need more detail regarding the recommendation for the FCA to consider setting social factor reporting expectations for managers to assess whether we support it. It would be useful to understand what expectations are envisaged and how standardised and decision-useful the recommended reporting would be.

We note that TPR and DWP are trustees' main sources of formal guidance on stewardship. The expectations of the FCA and FRC are more relevant to asset managers.

We are supportive of the other recommendations, in particular the recommendation for TPR to consider how it can help raise awareness of social issues among pension trustees alongside its climate change strategy.

We would like to see any recommendations for mandatory measures on pension schemes, asset managers or other parties to maintain a level playing field. Pension schemes should not be disadvantaged or incur additional costs compared to other investors, and asset managers should not be disincentivised from offering services to pension funds compared to other investors.

Government

We are broadly supportive of these recommendations, noting that the action in the Regulator section for the DWP should technically be included in this section. We encourage a supportive policy environment for action on social issues.

We think it is important to consider how useful developing a social taxonomy would be, given that social factors are often more related to corporate practice than to specific products and services.

We propose that an additional recommendation is added to this section, which would be further clarification of fiduciary duty, as referenced in the Green Finance Strategy, to encourage trustees to take a longer-term view of ESG factors, particularly with a view to addressing systemic risks.

Asset Managers

We are supportive of the recommendations put forward in this guide for asset managers. Although the opening paragraph of this section includes integration of social factors into managers' investment processes, we note that most of the recommendations focus on asset managers' stewardship activity.

We suggest adding explicitly a recommendation to undertake the systemic materiality assessment set out in the guide for their investment portfolios.

Data providers and proxy voting agencies

We have no comments on the recommendations to data providers and proxy voting agencies.

Investment Consultants

We are generally supportive of these recommendations, although we have some concerns around "*advice on social factors to be included in investment advice as standard, not as an additional expense*". In practice, each client will have a different approach to setting scope of work and fees, with different fee arrangements in place.

While basic advice on social factors is likely to be covered in existing fixed fees (particularly where there is already an item for responsible investment in the budget) we note that fees charged for any additional work will vary on a client-by-client basis depending on their individual fee structure and the scope of work being undertaken. Moreover, the amount of work that it is proportionate to undertake will vary depending on the size of scheme.

We would suggest changing the wording to "*Some advice on social factors to be included in investment advice as standard, not as an additional expense*". For example, for a manager selection exercise, manager assessments should include some consideration of social issues as standard, but if additional more detailed analysis is requested, an appropriate fee would be agreed.

Legal advisers

We have no comments on the recommendations to legal advisers.

Civil society / Non-governmental organisations (NGOs)

We are supportive of these recommendations in theory but have concerns around the practicalities of following them. We note that very few schemes will have the bandwidth and budget to engage with NGOs, but also that it is important for NGOs to be remunerated fairly for the time they spend assisting pension schemes on these issues. We also note that it may be difficult to find a suitable NGO partner, who will have appropriate knowledge as to how the social factor being considered fits in with the broader financial and pensions landscape.

We think that this section should be framed as recommendations for the industry, to seek input from NGOs who have experience of specific social factors.

Businesses and employers

While we view these recommendations as being broadly appropriate for businesses and employers, we would not expect many businesses and employers to read the guide. We also believe that pension scheme sponsors are unlikely to use this guide to set their own corporate social responsibility strategies. Therefore, it may be sensible for these recommendations to be reframed for:

- asset managers, so they can set these expectations for the companies they invest in; and
- government, so it can set these expectations for businesses on a broader level.

Q6: Do you find the information in appendices practical and informative?

We provide comments on each appendix below:

Appendix 1

We think this is a largely helpful appendix with a useful set of resources that can be used for assessing and understanding social factors. However, we believe the detail covered in this appendix is likely to be more than is needed by most pension scheme trustees, and hence have limited uptake. Instead, it is more likely to be used by investment consultants and asset managers, who would signpost relevant information to trustees on a case-by-case basis.

Appendix 2

We think this is likely to be the most useful appendix for the majority of pension trustees. It is helpful for trustees to have a set of questions readily available, a selection of which they can pose to their investment consultants and asset managers, along with guidance on how they can assess the responses received. We would therefore recommend giving more prominence to appendix 2.

We expect that for many pension schemes, the questions for asset managers are more likely to be used by investment consultants on their behalf, rather than by trustees directly, given the level of detail they contain. We would recommend trustees also ask questions about investment consultants' own DEI practices at an organisational level, and that both trustees and investment consultants ask questions about asset managers' DEI practices.

It would be useful for the guide to explain why the theme of human rights due diligence has been specifically highlighted in appendix 2.

An item could be added under "Potential items in mandates/side letters" to consider systemic risks, for example using clauses 9 and 10 of the ICGN GISD Model Mandate.

At the bottom of page 22 (Guidance for trustees) there is a statement "*we here offer some practical suggestions regarding… how to assess whether scheme trustees might benefit from setting their own voting policy*", but we don't see this addressed subsequently.

Appendix 3

This is a very comprehensive assessment of asset manager practices on modern slavery, and we are supportive of the inclusion of lived experience as part of this framework. However, in practical terms, we see appendix 3 as having limited use for trustees.

As noted in our opening comments, we would like some clarification as to why modern slavery has been selected as the focus.

Appendix 4

We view appendix 4 as useful, with helpful case studies to help bring to life the kind of action that pension scheme trustees, and investment managers on their behalf, could take, along with areas to focus on, to better address social factors.

Q7: Is there anything else that you would like to see covered?

We have noted or alluded to the following additional areas in our answers to previous questions, but we restate these key points here:

- Given that the guide is very detailed, we think an executive summary or QuickStart version of the guide would be helpful. Similarly, we believe more signposting would help trustees of smaller schemes navigate to the parts of the guide most relevant to them.
- We would like more detail on which social factors are considered to be the most material from a systemic perspective (although we note that the influence that schemes can have on each social factor outcome will depend on their portfolio-specific considerations, as set out in the systematic materiality assessment framework).
- We have observed that this guide specifically focusses on modern slavery and brings this out as a key case study and as an area to focus on. We would like more explanation on why this theme has been chosen.
- We propose a more explicit link is made in the guide between climate change and social considerations, referring to the importance of a just transition.

Additional detailed comments

We have some additional comments that are not directly addressed by the questions, which are as follows:

- On page 4 ("Social Factors and Pension Regulation" box), it's stated that "*Both Defined Benefit and Defined Contribution pension schemes must publish annual Implementation Statements, setting out their actions relating to [how they take account of financially material considerations and stewardship when making their investment decisions in their Statement of Investment Principles (SIP), including environmental, social and governance (ESG) factors] as well as relevant outcomes*". This is not strictly accurate, as the requirement to cover financially material considerations only relates to pension schemes that provide DC benefits (other than Additional Voluntary Contributions).
- On page 5, we would recommend removing the reference to the two-step Law Commission test in item 2 of the numbered list. This is because our understanding is that the current legal consensus disagrees with the two-step Law Commission test (specifically, that the shared member concern must be unanimous, a test which can never be met in practice).
- While we are supportive of the focus on systemic risks as set out on page 6, we think that an explicit definition would bring greater clarity. We recommend including some examples of systemic risks that are important for pension schemes, with justification as to why they are systemic risks.
- Similarly, we are supportive of the focus on salient risks described on page 7, but recommend this terminology is defined. We would propose using the United Nations Guiding Principles (UNGP) definition of salience.
- On page 8 there is consideration of the potential use of approaches such as scenario analysis and stress testing, as well as work on social tipping points to help improve modelling outcomes. Our preference is for a focus on the alternative suggestion set out on this page, namely the use of qualitative assessments of systemic risks, which should provide a strong enough justification for action. We prefer this approach given the challenges of quantitative modelling in this area, which we expect will persist for the foreseeable future. Our view is that a qualitative / narrative approach is likely to be sufficient for trustees to engage with and act upon.
- On page 9 there is a reference to the ICSWG standard set of metrics. In practice, there is only one metric in this set which is explicitly focussed on social factors, which is on United Nations Global Compact (UNGC) violators (although some other factors could have indirect social relevance). Our understanding is that ESG scores will soon be removed from the ICSWG metrics.
- On page 20, we would recommend adding Violation Tracker (US and UK versions) from Good Jobs First as a helpful resource.