Responsible Investment Advisory Group

Meeting of 26th May 2021
Item 5 Paper B
DWP Call for Evidence on Social Impact Investment

Issue

When it met on the 19th April 2021 the Investment, Governance and Engagement Committee agreed that RIAG should be invited to come forward with ideas on content to assist SAB prepare a response to DWP's call for evidence on social impact investment.

A summary of themes for SAB to take forward in their response based on comments from the group and suggestions from the Secretariat is at Annex A. Sections of the paper where input from RIAG is needed is highlighted in yellow.

Background

DWP has published a call for evidence on social impact investment (closing date June 16th 2021) at https://www.gov.uk/government/consultations/consideration-of-social-risks-and-opportunities-by-occupational-pension-schemes.

The 12-week Call for Evidence launched on the 19th April is seeking views on how pension scheme trustees understand social factors and how they are included in their Environmental, Social, and Governance (ESG) policies. The paper explains that social factors can present a wide range of potential risks to a scheme's investments, but they can also present lucrative investment opportunities. Responses will help inform Government on the steps needed to ensure that trustees are better able to meet their legal ESG obligations. This will help increase policymaker and industry understanding of what is currently being done, and what more could be done, to ensure both the risks and opportunities presented by social factors are adequately considered by pension schemes.

Consideration

RIAG members were invited by email on the 27th April to submit comments by the 19th May on how SAB should respond to the call for evidence.

Based on the small number of responses received the prevailing view is that SAB should emphasise the positive way in which the overwhelming majority of fund authorities have incorporated ESG policies into their investment strategies, set out the regulatory framework within which authorities formulate such policies and explain how these policies are made available for comparison and scrutiny.

The view was also expressed that the "S" of "ESG" has in recent times been overshadowed by the focus on the "E" and climate change in particular. On that basis SAB may wish to express support for the conclusion in the paper that pension funds should explore ways of ensuring that social impact considerations are not neglected at the expense of other non-financial considerations.

Recommendation – that the group considers the content of Annex A and agrees those that should go forward as recommendations for SAB to include in their response to DWP's call for evidence.

Annex A

Local Government Pension Scheme Advisory Board

Response to DWP Call for Evidence on Social risk and opportunity

Preamble and introduction

This call for evidence on social risk and opportunity, although aimed primarily at trustees provides the Board with an opportunity to highlight how the "S" of "ESG" has successfully been incorporated into the scheme's regulatory reporting framework and integrated into the investment strategies of individual fund authorities. The Local Government Pension Scheme (LGPS) is widely regarded as an exemplar of best practice in responsible investment.

The Board is mindful that the "S" of "ESG" has sometimes been the poorer relation and overshadowed by the historical focus on "G" and the recent inevitable focus on the climate change element of "E". Therefore. anything government can do to bring social impact considerations back into the mindset of investment decision makers can only be welcomed.

The LGPS's responsible investment journey started in 1998 when the scheme's investment regulations included a requirement for administering authorities to report against the ten Myner's investment principles. Later, in 2008, this was replaced by a requirement to comply with statutory guidance on preparing and publishing a Statement of Investment Principles which included a requirement to publish the policy, if any, on the extent to which social, ethical and environmental considerations are taken into account.

Authorities were also required to publish details about the exercise of rights, including voting rights, attaching to investments. In 2016 the scheme's investment regulations were further amended to require administering authorities to formulate a policy on environmental, social and governance considerations and for these to be published.

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The preparation and publication of policies on social impact investment by pension funds is only one half of the story. Checking implementation and measuring the success of such policies is equally, if not more important. Without these follow up measures, the publication of policies becomes nothing more than a tick box exercise with the risk that the proposed social benefits are not achieved.

It is also important to recognise that pension funds are only part of the solution. Asset managers and the companies in whom pension fund monies are invested are also key in ensuring that those responsible for formulating policies and making investment decisions have the necessary data to make reliable and effective policies and investment decisions.

Finally, there is the issue of accountability against ESG policies. LGPS pension committee meetings are held in public with individuals and special interest groups able to attend and hold pension committees to account for their policies and actions or otherwise under those policies.

Responses to 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?

For the LGPS in England Wales each of the 87 individual administering authorities are required to formulate an ESG policy against a single, national regulatory framework (Regulation 7(e) of the LGPS (Management and Investment of Funds) Regulations 2016 and associated statutory guidance (Preparing and maintaining an investment strategy statement 2017)

There is no requirement for a separate consideration of social factors and therefore they would be covered within the ESG policy. The Guidance states that *Investments that deliver social impact as well as a financial return are often described as "social investments". In some cases, the social impact is simply in addition to the financial return; for these investments the positive social impact will always be compatible with the prudent approach. In other cases, some part of the financial return may be forgone in order to generate the social impact. These investments will also be compatible with the prudent approach providing administering authorities have good reason to think scheme members share the concern for social impact, and there is no risk of significant financial detriment to the fund.*

The extent to which ESG policies are adopted and exercised are therefore subject to local variation but there is uniformity in the requirement for each administering authority to publish these policies in their Investment Strategy Statement that helps to achieve both transparency and the means to enable assessment of policies to be made across the scheme as a whole.

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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?

For the LGPS in England Wales each of the 87 individual administering authorities are required to formulate voting policy against a single, national regulatory framework and associated statutory guidance. The guidance is clear that Stewardship should be covered by that policy and in particular

Administering authorities are encouraged to consider the best way to engage with companies to promote their long-term success, either directly, in partnership with other investors or through their investment managers, and explain their policy on stewardship with reference to the Stewardship Code. Administering authorities should become Signatories to the Code and state how they implement the seven principles and guidance of the Code, which apply on a "comply or explain" basis.

The extent to which voting policies are adopted and exercised are therefore subject to local variation but there is uniformity in the requirement for each administering authority to publish these policies in their Investment Strategy Statement that helps to achieve both transparency and the means to enable assessment of policies to be made across the scheme as a whole.

Information on signatories to the stewardship code (and UNPRI) for the LGPS can be found at https://lgpsboard.org/index.php/2020-investment

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?
Need help from RIAG on this

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?
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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?
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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?
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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?

Yes

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

This will happen either individually, or collectively via organisations such the LAPFF https://lapfforum.org/engagements/record-year-for-lapff-voting-alerts/ or vehicles such as the relevant LGPS Pool. Although there is no specific legislative requirement to do many Individual funds will report on voting as part of their Annual Report (see example from the Responsible Investment section of the West Midlands Pension Fund Report at https://www.lgpsboard.org/images/Reports/2020/WMPF2020.pdf)

(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?
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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?
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