Local Government Pension Scheme Advisory Board

Response to DWP Call for Evidence on Social risk and opportunity

This response is submitted on behalf of the Local Government Pension Scheme Advisory Board (England and Wales) which is a body set up under Section 7 of the Public Service Pensions Act 2013 and The Local Government Pension Scheme Regulations 110-113.

The purpose of the Board is to be both reactive and proactive. It seeks to encourage best practice, increase transparency and coordinate technical and standards issues.

The response was compiled by the Board secretariat in consultation with members of the Board's Responsible Investment Advisory Group.

Jeff Houston
Secretary to the Board
June 2021

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.

In framing this response the Board has considered the two aspects of social factors as set out below and where appropriate the answers refer to one or both:-

1. The measurement of social factor risk and opportunities relating to existing investments and subsequent action taken through engagement to improve those factors.

2. The assessment of social factors when deciding how to invest to produce a positive impact.

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.

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 86 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[1] and associated statutory guidance (Preparing and maintaining an investment strategy statement 2017)[2].

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*

[1] UKSI 946 of 2016 https://www.legislation.gov.uk/uksi/2016/946/made/data.pdf
[2] https://www.gov.uk/government/publications/local-government-pension-scheme-guidance-on-preparing-and-maintaining-an-investment-strategy-statement

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.

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 and Wales each of the 86 individual administering authorities (LGPS Funds) are required to formulate a 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 2012 stewardship code (and UNPRI) for the LGPS can be found within the most recent scheme annual report at https://lgpsboard.org/index.php/2020-investment

The emphasis in the guidance on collaboration is reflected in the fact that nearly all the LGPS Funds in England and Wales are members of the Local Authority Pension Fund Forum (https://lapfforum.org/) which provides a focus for collaborative engagement with companies.

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?

The motivation for investors to do so comes from a holistic view of ESG risk and opportunity with the starting point being what is material to the portfolio, but also incorporating the LGPS Fund's perspective. So for example, the focus could be on modern slavery, human rights and Big Tech and workforce issues.

Some LGPS funds will use the UN Global Compact as a means of measuring how well companies are performing on specific issues which will then allow engagement to be targeted. The pandemic has also generated an interest in other issues for example whether supermarkets have taken or paid back rate rebates. Clearly those generating additional profits and not taking state support score better.

The issue of tax compliance / avoidance would also be something we would suggest falls in this area as it is about companies acknowledging that they exist in a society to which they have some responsibility.

The other area which could be covered more effectively within “human rights” is relations of companies with the communities in which they operate. Particular examples would be around indigenous communities and mining companies.

Finally, there is also growing recognition of the link between climate change and social factors. In conversations with corporations around climate change, many Funds will be asking corporations to consider the social implications of the transition to a low-carbon economy and in particular the S factor of a ‘just transition’ (https://www.appglocalpensionfunds.org/?p=141) is likely to grow in prominence.

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?

- PLSA/High Pay Centre work on workforce disclosure and what investors should look for in annual reports. Understanding the worth of the workforce – a stewardship toolkit for pension funds (plsa.co.uk)
- Human Capital Management: Why investors should care and what they should look for in corporate disclosure | ICGN
- Home | Human Capital Management Coalition (hcmcoalition.org)
- https://www.frc.org.uk/getattachment/59871f9b-df44-4af4-ba1c-260e45b2aa3b/LAB-Workforce-v8.pdf
- CCLA Modern Slavery (modernslaveryccla.co.uk)
- https://www.rathbones.com/sites/rathbones.com/files/imce/5558_votes_against_slavery_2021_final_16_feb_2021.pdf
- Workforce Disclosure Initiative (https://shareaction.org/workforce-disclosure-initiative/)
    - As an example: The Workforce Disclosure Initiative (WDI) co-hosted a thematic workshop on the changing landscape of human rights due diligence and workforce reporting in the context of Covid-19 together with EOS at Federated Hermes in 2020. The event allowed companies and investors to learn more about the WDI and speak candidly about the challenges and opportunities faced when conducting human rights due diligence.
- The Mining and Tailings Safety Initiative (https://www.churchofengland.org/about/leadership-and-governance/church-

england-pensions-board/pensions-board-investments/investor-1)Development of industry standards on S issues, such as a project led by the Ethics Council to the Swedish AP Funds and supported by (amongst others) LGPS Central: Investor Expectations on human rights for technology companies. Expectations have been shared with Google (Alphabet), Amazon, Apple, Facebook, Microsoft and Twitter with engagement ongoing.

Coverage in this area is much less comprehensive than in the E areas, as is the overall level of disclosure which means that it is more difficult to assess which companies to target for engagement.

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?

Approaches to managing the risk in the LGPS include:

- Identify policy objectives
- Balance long term aims of helping make societal improvements that will be beneficial for investments with short to medium term needs to protect value of the assets against potential impacts associated with S i.e. engage for the former to have business models changed appropriately, but be cognoscente of the need to divest in others where the speed of change may not be fast enough
- Analyse the existing position using PRI SDG where possible
- Recognise the benefit that pooling has had in relation to the ability of pooled fund users to have a greater voting power
- Evaluate any compromises in policy that are a feature of the fund management approaches available.
- Engage with managers on these compromises to help shape furture management
- Looking at performance in the context of sustainability and impact in line with SDGs
- Assessing the governance structures of companies
- Engagement to seek to achieve change in company behaviour
- Using asset managers with a proven track record in this area to ensure that social risks are taken into account
- Top-down, market-wide lens. Identifying Stewardship themes based on their economic relevance/market impact, our ability to resource and stakeholder concern. This helps prioritise and direct engagement.
- How high up is human rights and labour rights? Still more “incident” driven set of issues, rather than systematically assessing as part of ESG integration. Like Uyghur people’s rights or Palestine/Israel conflict.
- However, the market repercussions of COVID 19 brings home the importance of S. Equally, the interlinkages between planetary and human health
- Consider the impact of blended beliefs that Committee’s may have ie E, S and G beliefs are typically interlinked (e.g. climate and the importance of a “Just Transition” to a low-carbon economy

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In terms of the opportunities these are more likely to come in areas such as impact funds and social housing which are considered within the relevant asset class category against the standard performance hurdles for the asset class.

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?

Where this is delegated to the asset manager in respect of regulated market assets the LGPS fund would continue to have an active oversight role and will discuss particular issues or votes with the manager where they are aware of issues. This could include regular fund manager review meetings, IMA updates, RFP requirements, fund manager remuneration, or sanctions such as cancelling our investments with the manager.

In private markets for the legacy (pre-pooling) portfolio the LGPS fund would look to the managers, and may also have engaged a research company to undertake work helping them systematically gather information on a wide range of impacts using the SDG's as an analysis framework.

Where assets are part of an LGPS Pool this would be managed through the pool company.

Make use of PRI SDGs and voting/engagement data but recognise that data is as yet incomplete but is moving in the right direction. By creating a heatmap of desirable qualities the LGPS should be able to form a positive feedback loop with managers to help them shape their future offerings and the availability of desirable solutions to all investors

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, although see also (c)

(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, directly or via the asset manager, 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. Pool companies report on their activities in terms of both voting and engagement. For example, Border to Coast's latest report (1/4ly and annual) links below:

https://www.bordertocoast.org.uk/app/uploads/2020/07/Border-to-Coast-Responsible-Investment-Report-2019_20.pdf
https://www.bordertocoast.org.uk/?dlm_download_category=engagement

Although there is no specific legislative requirement to do so, most individual LGPS Funds report on voting as part of their Annual Report. For example:

From the Responsible Investment section of the West Midlands Pension Fund Report at https://www.lgpsboard.org/images/Reports/2020/WMPF2020.pdf

South Yorkshire Pension Authority (see Responsible Investment at page 142) of the 2019-20 Annual report at
https://lgpsboard.org/images/Reports/2020/SouthYorkshire2020.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?

There may be issues for some LGPS Funds in this area if it is delegated to asset managers. These could include:

- Lack of effective communication
- LGPS Funds not having the resources to develop targeted stewardship policies
- Managers not taking on board the Fund's views, either because they have a 'house view' or in a pooled situation the manager cannot reconcile the LGPS Fund's view with those of other clients
- LGPS Funds not checking up on manager actions
- Inability to vote in line with the Fund's policy when invested in passive funds.

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?

This is a much more difficult area. Clearly there are areas like micro finance and mobile banking which have potential to deliver both impact and return but packaging these opportunities in ways that could be attractive for institutional investors do not seem to exist.

Comments below from the Board's Responsible Investment Advisory Group

'Certainly, this type of investment is not something I have been approached about while there is a long queue of people pushing social impact opportunities in Europe and the UK.'
'I personally think it (social investment*) is becoming more mainstream than we may have thought and I am also seeing opportunities in EM'*

(It is) *'worth noting that direct or indirect investing in emerging markets to help address social issues is likely to be quite risky from an investment perspective, which could limit involvement from LGPS. Some level of government vehicle with some security or guarantee could help reduce risk and open up more investment opportunities.'*