Consultation on consideration of social risks and opportunities by occupational pension schemes

Response from the Pension Protection Fund

June 2021

About the PPF

The Pension Protection Fund (PPF) was established to pay compensation to members of eligible defined benefit pension schemes, when there is a qualifying insolvency event in relation to the employer and where there are insufficient assets in the pension scheme to cover PPF levels of compensation.

The PPF is a statutory fund run by the Board of the PPF, a statutory corporation established under the provisions of the Pensions Act 2004. The PPF became operational on 6 April 2005.

On 10 July 2009 the Board of the PPF was also given the responsibility of being the scheme manager for the Financial Assistance Scheme (FAS). FAS provides assistance to members of eligible underfunded defined benefit schemes that started to wind-up between 1 January 1997 and 5 April 2005, or between 6 April 2005 and 27 March 2014 where an employer insolvency event occurred before 6 April 2005.

Our responsible investment strategy

Responsible investment (RI) is an important part of our overall strategic plan and our core investment principles and strategy.

The goal of our RI strategy is to enhance the long-term value of our investments by managing environmental, social and governance (ESG) risks and exploiting opportunities.

We take a materiality-based approach to relevant ESG factors, and ESG integration (including but not limited to climate change) is achieved by engaging with and advancing the ESG practices of our external managers and underlying issuers, rather than divesting. We expect our external managers to integrate all relevant material factors into their investment analysis and decisions, and demonstrate active stewardship.

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?**

Yes, the PPF has a policy regarding financially material factors across the spectrum of environmental, social and governance issues, which are considered separately as well as ESG factors more broadly.

Our RI policy is formed from our two core beliefs:

1. By acting as a responsible and vigilant asset owner, we can protect and enhance the value of our investments.

2. ESG factors, and especially climate change, can have an impact on the performance of our investments, and the management of these risks and opportunities can add value to our portfolio.

We view ESG factors as the interaction of our investments with:

- the physical environment and climate (Environment)
- communities, workforces, wider society and economies (Social)
- governance structures of the organisations and markets we invest in (Governance)

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?

Yes, the PPF has an overall stewardship policy which incorporates both our engagement and voting approaches across key ESG themes, including specific social factors.

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?

Within our stewardship policy, through the guidance of our external provider for stewardship services, 12 themes have been identified across environment; social; strategy, risk and communication; and governance, which cover material issues relevant to companies in all regions and sectors. These themes have been selected to focus stewardship on the issues with greatest potential to deliver long-term sustainable wealth for investors and positive societal outcomes. Social factors considered include (but are not limited to):

- human capital management
- diversity and inclusion
- human and labour rights
- conduct, culture and ethics
- business purpose and strategy

We also have a minimum standards policy, which sets out our requirements for responsible conduct from our underlying issuers and external managers. This policy is aligned with:

- internationally recognised norms, such as the UN Global Compact, UN Guiding Principles on Business and Human Rights and the OECD Guidelines for Multinational Enterprises
- international conventions for controversial activities that are ratified into UK law, such as the UN Anti-Personnel Landmines Convention or Convention on Cluster Munitions

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?

As signatories to the Principles for Responsible Investment (PRI), we leverage off guidance and support materials from the PRI, including understanding and evaluating social issues in our investments, and joining collaborative engagements on specific issues. Alongside the PRI, we also utilise our external provider for stewardship services, EOS at Federated Hermes (EOS), to lead and inform us on engaging and monitoring companies on social issues. We also consume ESG data from external data providers and apply a materiality lens that is informed by the Sustainability Accounting Standards Board (SASB) materiality matrix.

In a less systematic way, we will use other collaborations and initiatives as we see fit. In addition, we do not believe there is a clear divide between the E, S and G for many issues, for example climate change, which we view as a systemic issue that has both environmental and social implications.

We agree with the view that, generally, social issues are often less reported on by both companies and investors (certainly in terms of quantitative data), and can be harder to identify and measure performance on. Therefore, we would be mindful to say that we do not have a complete view of how companies perform on social issues. Given this, we welcome the recent announcement from the IFRS Foundation on the formation of a working group to accelerate convergence in global sustainability reporting standards focused on enterprise value.

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?

From a stewardship perspective, we normally engage directly with our external managers and external agents, rather than directly with individual issuers as we feel we have the greatest influence at this stage. We expect our external managers to actively engage with companies on our behalf and continuously monitor them on their overall ESG performance and stewardship activities.

However, we do also participate in industry-wide collaborative initiatives to help develop best practice and to ensure that our own RI standards are aligned with industry standards. One recent example of this is our participation in the PRI's Votes Against Slavery (VAS) collaborative engagement. This initiative was set up to coordinate the response of the investment community and to provide the necessary accountability for compliance with the UK's Modern Slavery Act 2015. The VAS project targeted laggard companies in the FTSE350 and engaged directly with them, and is believed to be one of the largest coalitions on a social theme to-date.

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?

While this is delegated to our external agents, we maintain oversight of our agents by monitoring their voting and engagement practices and seek to enhance the quality and quantity of their stewardship activities.

We expect our external managers to integrate all relevant material factors into their investment analysis and decisions, and demonstrate active stewardship. Before we appoint external managers, we carry out extensive due diligence on their RI policies and approach to ESG integration, which not only includes minimum requirements that they must meet, but also a consideration of how they might go beyond those minimum standards. On an ongoing basis, we use ESG data internally via our portfolio management systems combined with regular ESG reporting from our managers to carry out this monitoring. For high profile voting issues, where possible, we will enquire about our external managers' voting intentions ahead of AGMs.

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

The main barrier we face in undertaking stewardship activities (engagement or voting) directly with an investee company is the time and resources required to carry this out effectively.

As mentioned above, the PPF has participated in the PRI's Votes Against Slavery collaborative engagement recently. As a large UK asset owner, we felt it was important that our presence and asset base was associated with such an important initiative, especially given the recent supply chain issues that have come to light in the UK in the wake of the Boohoo modern slavery investigation in July 2020.

61 companies were contacted by the lead engager (Rathbones) in March 2021 as part of this year's review of the public disclosures from companies listed on the FTSE350 index, which was carried out by Business & Human Rights Resource Centre (BHRRC). The engagement has successfully encouraged compliance from nearly 50 companies so far this year. A key benefit of this type of engagement is the scale and speed at which tangible results have been delivered across a large number of companies.

Our external agents have also carried out a number of stewardship activities on our behalf. Examples can be found in our RI Report and our annual voting and engagement reports, on our website (Reporting and investing transparently | Pension Protection Fund (ppf.co.uk)).

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 terms of the PPF's approach to managing our investments, all potential investments must meet our risk-adjusted return requirements over the time horizon of the investment, with any material E, S or G factors integrated into the investment thesis.

In order to improve the attractiveness of projects that bring social benefits alongside financial returns, private investors will need to see the support of first-loss/mezzanine loan instruments or guarantees within funds to crowd in private capital from pension funds (e.g. from development or infrastructure banks).

In addition, for those schemes with substantial assets, any allocation made to an asset or investment mandate must usually meet liquidity and diversification requirements, which means that investing in small start-up businesses is not always a realistic opportunity for larger investors.

Supplementary Comment

Although not directly addressed through this consultation's questions, it's also important to note that we aim to manage our own organisation in line with ESG principles. Our members don't choose to come to us, but nevertheless we seek to match our expectations of our asset managers in the expectations we set for ourselves. We recognise that we are part of an industry where attracting diverse talent is a challenge, but we are working hard to address areas of under-representation. We can't change the industry we're part of, but we can be part of the solution – although we recognise it will be some time before our statistics start to reflect the effort we are putting in.