ICGN
International Corporate Governance Network

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Subject: Call for Evidence: Consideration of social risks and opportunities by occupational pension schemes

The International Corporate Governance Network (ICGN) is pleased to respond to the UK Department for Work and Pension (DWP) call for evidence: Consideration of social risks and opportunities by occupational pension schemes.

Led by investors responsible for assets under management in excess of US$59 trillion, ICGN is a leading authority on global standards of corporate governance and investor stewardship. Our membership is based in more than 40 countries and includes companies, advisors and other stakeholders. ICGN's mission is to promote high standards of professionalism in governance for investors and companies alike in their mutual pursuit of long-term value creation contributing to sustainable economies world-wide. ICGN offers an important investor perspective on corporate governance and sustainability to help inform public policy development and to encourage good practices by capital market participants.

ICGN welcomes the DWP consultation on the important role of occupational pension schemes in addressing social factors, both in terms of risks and opportunities. It is really encouraging that the DWP is seeking to position social risks and opportunities as requiring as much focus by the DWP and UK occupational pension schemes as other long term systemic issues such as climate change.

Social factors as a governance priority

The governance of sustainability and the relevance of social factors feature significantly in ICGN's policy agenda. We have consciously enhanced our reference to the importance of social factors and stakeholder engagement more broadly in our recent revision to the ICGN Global Governance Principles (relevant sections provided in annex 1). First published in 2001, many ICGN Members default to the Principles as a bellwether for their voting policies and company engagements. The Principles also inform regulators on international standards to help inspire the development of national codes. The updated Principles will be put forward for ICGN member approval in its annual general meeting in September 2021.

These changes acknowledge that modern day governance and stewardship practice requires a commitment to shareholder return on capital while having regard to the interests of stakeholders, including the workforce, customers, suppliers, and communities. This is particularly relevant now, as stark social inequalities have been exposed by the COVID pandemic. ICGN's Statement of Shared Responsibilities[1] published last year emphasised this and the importance of social factors as a key determinant to a company's long-term value creation.

ICGN's approach aligns with the United Nations Sustainable Development Goals (SDG)[2] to *'achieve a better and more sustainable future for all'*- and particularly SDG 3 on 'good health', and SDG 8 on 'decent work and economic growth.[3]

The COVID pandemic has elevated the importance of ordinary workers as pivotal to a company's long-term success, particularly as our economies have shifted away from manufacturing to knowledge-based industries. Good practices around health and safety, training and incentives are crucial for worker satisfaction, leading to higher productivity and superior services for customers. This helps companies innovate and remain competitive in a global economy and is a key driver of long-term value creation.

The pandemic has put a bright spotlight on how a company manages its workforce, its social license to operate, company reputation and culture as well as supply chain due diligence and resilience, and diversity, equity, and inclusion on corporate boards and across the workforce as a whole. As a result, the materiality of these issues is now much more recognised by investors, along with how they link to other financial, environmental and economic factors.

While the DWP consultation focuses on the management of social factors by UK occupational pension schemes, we believe these issues are relevant globally and we welcome the DWP's recognition that social factors are sources of systemic risk, and opportunity. In the spirit of sharing information, and to provide the DWP with an important global comparison we have included in Annex 2 a summary of how the DWP questions are being addressed in an Australian context with insights from the approaches of Australian pension funds, written by an ICGN Member.

Social factors have major relevance for pensioners with long-term investment horizons. It is not just about managing and mitigating downside risk and we consider that the opportunity is significant if these factors are managed appropriately over the long term. In this way, diversity and other ways to optimize human capital management, can be seen as an opportunity set within social factor integration into investment portfolios.

We also perceive an interconnectivity of these systemic social issues, together with other environmental, governance and economic factors. Social factors manifest themselves at a company level (such as supply chains, health and safety issues, board and workforce diversity, product recalls, workers' rights) and at a systemic, market level (including globalisation, inequalities, artificial intelligence and digital disruption). They reflect matters of both ethics and

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[1] ICGN letter to Corporate Leaders, 23 April 2020 (English language): https://www.icgn.org/sites/default/files/6.%20ICGN%20Letter%20to%20Corporate%20Leaders_23%20April%202020_0.pdf

[2] https://www.ilo.org/global/topics/dw4sd/themes/osh/WCMS_558571/lang--en/index.htm

[3] Decent work is employment that "respects the fundamental rights of the human person as well as the rights of workers in terms of conditions of work safety and remuneration. ... respect for the physical and mental integrity of the worker in the exercise of his/her employment."

economics and these two lenses need to be used in how these issues are managed over the long term.

We believe that there is greater scope for addressing social factors through the investor stewardship. ICGN's Global Stewardship Principles[4] outline investor responsibilities to take account of systemic risk and sustainability (including social and environmental) related factors, in their investment analysis, company engagements and voting decisions. Increasingly, we are seeing shareholder resolutions on systemic issues (including racial equity audits, diversity policies, human rights and corporate lobbying).

Market-led initiatives related to social factors

As a further example of investor stewardship activity, we are encouraged by the formation of investor bodies and collaborative initiatives in this domain. For example, many UK occupational pension schemes are members of the 30% Club's UK Investor Group and 30% Club Investor Groups (focusing on diversity) now exist in the UK, Japan, Brazil, Canada, Australia, and France.

Other initiatives include the 40:40 Vision initiative led by HESTA super fund in Australia and in the US the 30% Coalition. In the UK, the Workforce Disclosure Initiative is also relevant. Many of these collaborations have strong representation from pension funds, including as leaders of these collaborations.

Converging investor opinion on optimal disclosure

It is evident that companies with higher standards of human capital management (HCM) are better equipped to sustainably improve corporate value.[5] But investors lack consistent and reliable data to assess performance which is crucial for decision making around investments, voting or company engagement.

Mandatory disclosure is limited in most markets. So, investors must rely on voluntary reporting that is often boilerplate, supplemented by data from research firms. While this is helpful, it does not enable deep analysis of specific companies or comparisons to be made amongst competitors. A multiplicity of reporting frameworks is also inefficient for companies, causing complaints about survey overload.

However, there is growing consensus around how companies should measure the contribution of their workforce and what should be disclosed. Many ICGN Members are calling on regulators to require companies to publish better information around how human capital is managed as part of a longer-term strategy for value creation.

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[4] ICGN Global Stewardship Principles
[5] See Bernstein, Aaron and Larry Beeferman, The Materiality of Human Capital to Corporate Financial Performance, Pensions and Capital Stewardship Project, Labor and Worklife Program, Harvard Law School, 2015, available at: https://lwp.law.harvard.edu/files/lwp/files/final_human_capital_materiality_april_23_2015.pdf

By way of example, last year, ICGN issued a letter[6] to support the Human Capital Management Coalition (a group of investors responsible for $6 trillion assets) which called on the United States Securities and Exchange Commission (SEC) to require companies to disclose information about their human capital policies, practices and performance.

The SEC Chairman, Jay Clayton, emphasised the importance of human capital in a statement discussing the need to maintain connections amongst markets, business and workers in managing the COVID crisis. He said, *"I believe that the strength of our economy and many of our public companies is due in significant and increasing part to human capital and, for some of these companies, human capital is a mission critical issue."*

ICGN subsequently welcomed a change of reporting rules by the SEC to require companies to report 'material' human capital objectives. This is a useful 'first step' but we encourage the SEC and other regulators to require more comprehensive disclosure – including information around the indirect workforce (contract, part-time and temporary).

Since the new SEC rule was in the U.S, there has been a surge of HCM reporting however a recent study[7] finds that disclosure is limited: a third of companies sampled described their approach to HCM in just 300 words or less (and typically on a single topic), while another 48% published 1,200 words or less. This is inadequate to be genuinely useful to investors.

Disclosure should be tailored to the company's specific HCM strategy and include information on topics such as:

- Investment in training
- Lost-time injury and fatality rates
- Pay ratios (across highest, media and lowest quartiles)
- Turnover (voluntary and involuntary, internal hire rate)
- Compensation and incentive plans
- Workforce demographics (full time, part time, agency)
- Workforce engagement, union representation, work-life initiatives
- Gender, ethnic and racial diversity across different workforce levels particularly in relation to recruitment, retention and promotion

This data may seem overwhelming, but companies already generate this for internal purposes. So publicly disclosing the data is not likely to require burdensome new data collection systems and reporting frameworks. And importantly, a consistent approach to definitions will enable investors to compare companies on HCM, as they do in more traditional financial metrics. Disclosure should also be supplemented with key performance indicators (KPIs) covering relevant policies and their outcomes. This should include measurable goals and a period over which KPIs are achieved.

[6] ICGN Letter to U.S. SEC re Modernization of Regulation S-K Items 101, 103 and 105, 26 August 2020
[7] Human Capital Management Proxy Disclosures; sample of December 2020 & January 2021 proxy filings, Semler Brossy, [PowerPoint Presentation (semlerbrossy.com)]

Ultimately, boards and shareholders have a mutual responsibility to preserve and enhance long-term corporate value, contributing to economic growth, social prosperity, security, and a healthy environment. This includes recognition of the materiality of social factors to long-term corporate performance, innovation, risk and sustainable value creation.

We hope that our comments are helpful, and we look forward to engaging with you in this or other matters where we could provide meaningful input. Should you wish to discuss our comments further, please contact me or George Dallas, ICGN's Policy Director, by email at george.dallas@icgn.org.

Yours faithfully,

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Appendix 1: ICGN Global Governance Principles

4.6 Stakeholder relations

The board should ensure that the corporate culture supports positive stakeholder relations and engagement (particularly with the workforce), supported by relevant metrics to identify strengths and weaknesses. Boards should ensure there is a process for the identification of relevant stakeholders, establish a stakeholder engagement policy and an external communication mechanism for stakeholders, including a process for review of stakeholder grievances.

4.7 Human rights

The board should ensure that it is sufficiently informed of how human rights and modern slavery issues may present material business and reputational risks or might compromise a company's own values and standards of behaviour. The Board should establish appropriate due diligence processes, strategy, disclosure, engagement, accountability, and other measures to deal with human rights issues which may materialise in connection with the company's workforce and operations.

4.8 Workforce safety

The board should ensure transparent reporting and disclosure of how a company identifies, prevents and mitigates workforce safety risks in its operations and supply chains, particularly in terms of the risk assessment process, policies and procedures.

7.6 Human capital disclosure.

Boards should oversee a company's approach to human capital management (HCM) as part of longer-term strategy for value creation. This relates to talent management, succession planning, workforce retention and training in alignment with the company's Diversity, Equity and Inclusion Policy and complying with legal requirements, e.g., workforce health and safety and human rights. Companies should disclose their HCM policies which should clarify objectives, measurable goals and key performance indicators on an annual basis. This extends to the impact of the workforce on company value in relation to costs, productivity, quality and revenue.

7.7 Materiality and sustainability

Disclosures should focus on materially relevant factors, with many environmental and social factors being sector specific, linked to the company's management of its natural and human capital. Where possible, sustainability related reporting should also seek to address "double materiality", which includes reporting on the company's own social and environmental impacts, as well as on how sustainability related factors may impact the company's own financial performance. Moreover, boards should build an awareness of "dynamic materiality", including how externalities and those sustainability related factors that may not be immediately impactful on a company's finances or operations can evolve to become financially material over time.

7.8 Sustainability standards

The board should encourage the company to utilise established sustainability related accounting and reporting standards and frameworks to facilitate consistency and comparability of reporting and to contribute to the global consolidation of sustainability related standards. The methodology and use of objective metrics underlying the company's disclosure should be rigorously explained.

Appendix 2: An Australian comparison

As the DWP is looking for evidence on social issues being considered by occupational pension schemes, we attach here a summary of how the DWP questions are being addressed in an Australian context. It was prepared by Nga Pham an academic researcher at Monash University in Australia and member of ICGN's Disclosure and Transparency Committee. We hope this comparative perspective will add new insights to the DWP's consideration.

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?

- Just a few have described ESG factors separately in their responsible investment (RI) policy statement (examples HESTA[8] lists *engaged and healthy workforce, community*

[8] https://www.hesta.com.au/about-us/what-we-stand-for/responsible-investment/our-commitment.html#:~:text=We're%20committed%20to%20changing,an%20investment's%20long%2Dterm%20value.

expectations, healthy supply chains and just transition as social factors, Aware Super[9] (*modern slavery, workforce diversity, labour relations, workforce safety*), REST Super[10] (*Modern slavery, human rights, Indigenous rights, Workforce e.g. fair pay, health and safety, wellbeing, Diversity and equal opportunities)*

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?

- Most large Australian super funds adopt the ASCI's Australian Asset Owner Stewardship Code[11]. The Code[12] makes reference to incorporating ESG considerations into investment strategies and engagement. However, there is no mentioning of specific considerations for social factors in separation of E and G factors. Most funds have a brief stewardship statement stating that they adopt ASCI's Code.

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?

Sectors with key social concerns, as reported by RIAA[13]

- Tobacco
- Armaments/controversial weapons
- Human rights and modern slavery
- Gambling
- Uranium/nuclear Power
- Animal cruelty
- Alcohol
- Genetic engineering
- Pornography

Some big themes adopted by super funds for responsible investment/impact investments/engagement activities

- Job creation, innovation and small business growth
- Affordability and access to basic services, e.g. healthcare, retirement living
- Workplace safety, workplace diversity
- Regional development, Sustainable Cities and Communities
- Responsible Consumption and Production
- The transition to a low carbon economy (social aspects of)

[9] See their RI Statement: https://aware.com.au/member/investments-and-performance/our-approach-responsible-ownership
[10] https://rest.com.au/member/investments/approach-to-responsible-investing
[11] https://acsi.org.au/members/australian-asset-owner-stewardship-code/
[12] https://acsi.org.au/wp-content/uploads/2020/01/AAOSC_-The_Code.pdf
[13] https://responsibleinvestment.org/wp-content/uploads/2019/12/RIAA-Responsible-Investment-Super-Study-2019.pdf

- Sustainable digitalisation
- Seafarers' welfare
- First Nations' Peoples' Rights, including free prior and informed consent (FPIC) and heritage protection
- Modern slavery in operation and supply chain

Examples of current campaigns:

- Xinjiang Uyghur Autonomous Region in China ➔ investors' submission into parliamentary inquiry into proposed modern slavery legislation banning imports from Xinjiang region and potentially elsewhere in China.
- Investors against slavery and trafficking ➔ issued an investor statement to the ASX 100 companies in late 2020 outlining what the signatories of the investor statement expect from them

International norms, conventions and guidelines (ordered from most to least used)

- Principles for Responsible Investment
- Cluster Munitions Convention
- UN Global Compact (10 Principles)
- International Labour Organization Conventions
- Ottawa Treaty on Land Mines
- Universal Declaration of Human Rights
- UN Guiding Principles on Business and Human Rights
- Sustainable Development Goals
- United Nations Convention Against Corruption
- International Bill of Human Rights
- UN Convention on the Rights of the Child
- OECD Guidelines for Multinational Enterprises
- The Bible/or other religious script

While industry, public and retail funds follow more conventions and guidelines, corporate funds reported the least use.

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? *(collected from RIAA's resources and reports)*

- EcoVadis - global supply chain sustainability ratings platform that can provide supplier questionnaires
- Informed Supplier365 Portal (Accessible by suppliers and cross-industry partners)
- Mekong Club, Fintel Alliance, International Labour Organisation, Social Hotspots database, Transparency International
- Worldwide Responsible Accredited Production (WRAP)
- Transparency International's Corruption Perceptions Index

- United States Department of Labour - List of Goods produced by child labour or forced labour
- Fair Farms, Staff Sure, Forced Labour Index, Children's Rights in the Workplace Index, ITUC Global Rights Index
- "Global News Sources" and ESG controversies databases
- UN Human Development Index
- US State department (Country analysis), ILO Department of Statistics, Modern Slavery risk heatmap
- Social Hotspot Database
- Walkfree Analysis 2018
- ITUC Global Rights Index
- Verite 2015 "Strengthening Protections against trafficking"
- US Department of States Trafficking in Persons Report
- Unicef Child Labour Data

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?

Risks and opportunities of super funds in Australia on the funding side:

- According to a study by RIAA[14], the top specific social issues Australian consumers want to avoid with their investments are animal cruelty (60%) tobacco (54%), weapons and firearms (54%), human rights abuses (51%) and gambling (50%).
- RIAA's study reveals that people will take action if they feel their money isn't invested in line with their values and interests. They will switch bank or super fund, if need be, and are seeking greater transparency to make more informed decisions. More pressure tends to come from younger generations and women.

  Risks and opportunities on the investment side

  ESG factors are:

  - Considered in strategic asset allocation (39% of funds).
  - Incorporated into manager Investment Management Agreements (IMAs) (47% of funds).
  - Tasked to investment managers with executing voting policies in alignment with fund's investment beliefs and strategy (26%).
  - Systematically or occasionally reviewed by an internal team or have external managers review (but 50% of corporate funds and 27% of retail funds do not have any review mechanism in place).

[14] RIAA: Responsible Investment Association Australasia: https://responsibleinvestment.org/wp-content/uploads/2020/03/From-Values-to-Riches-2020-full-report.pdf

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?

- Funds use asset consultants to provide assessments on the ESG capabilities of managers and assign specific weighting to ESG factors in manager evaluation.
- Funds discuss minimum responsible investment expectations with external managers.
- Funds explicitly require ESG reporting as part of standard IMAs with external investment managers

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?

- According to RIAA[15], almost half the super funds (49%) have formal engagement policies and processes in place, with most of those funds involved in direct company engagement (44% of the sample), and 67% on a collaborative basis.
- Less than half publish engagement reports.
- 77% of super funds identify external managers as having responsibility for responsible investment to some degree.
- When it comes to voting policies, just 26% call for investment managers with executing voting policies in alignment with the super fund's investment beliefs and strategy.
- Investor-NGO collaboration in collaborative engagement ➔ Difficulty in choosing which investor initiatives to join, especially for global companies.
- Investor-led initiatives: RIAA initiated the HRWG with quarterly meetings, forum for investors to exchange ideas, Stock Watch report, joined effort in corporate engagement, knowledge hub, modern slavery DD best practice, industry collaboration, investor toolkit – companies in conflict zone.

Areas of challenges for investors:

- Compartmentalised reporting and disclosures (i.e., how does human rights reporting relate to sustainability reporting?).
- Multiple supply chain software, services and mapping tools.
- Companies struggle with how to determine their whole supply chains (a tool kit would be very useful) and how to audit suppliers (e.g., challenges of auditing suppliers in Xinjiang).

[15] https://responsibleinvestment.org/wp-content/uploads/2019/12/RIAA-Responsible-Investment-Super-Study-2019.pdf