Consideration of social risks and opportunities by occupational pension schemes

Nest's response to the consultation

About us

Nest was established in 2010 as part of the auto enrolment programme to help people save for retirement. Unlike any other pension scheme in the UK, Nest has a legal obligation to accept any employer that wishes to use us to discharge their auto enrolment obligations. Over 900,000 employers have signed up to use Nest.

Over the last decade, Nest has grown to be one of the largest pension schemes in the UK. We are operating at scale as a high quality, low cost pension scheme helping over 10 million members save for their retirement. Many are low to moderate earners who may be saving into a pension for the first time. A typical Nest member earns around £20,300 per year and nearly half our members are under 35 years old.

Nest is built around the needs and behaviours of our members, from our approach to responsible investment to our focus on customer service. We now occupy a place in the market as a major Master Trust, helping to drive up standards and best practice across the industry. Nest has great potential for delivering pensions to mass market consumers for many years to come, leveraging our scale to deliver value through the combination of low costs, our market leading investment strategy and modernised services all overseen by strong trustee governance.

Response

Nest welcomes the DWP's Call for Evidence to seek views on the effectiveness of occupational pension scheme trustees' current policies and practices in relation to social factors. We also welcome the Government's desire to understand how schemes integrate considerations of financially material social factors into their investment and stewardship activities.

To date, climate change has been one of the most prominent ESG issues for Nest because it presents both a clear and significant financial risk to our investment portfolios and a real existential crisis for the industry and our members. It has also been a focus in recent years for policymakers and regulators. Despite this, we have a track record of addressing material social risks and opportunities across our portfolio, where they have significant implications for companies' long-term value.

We recognize DWP's concern that social issues in general have had less of a focus in relative terms across the industry, and we believe the Covid-19 pandemic has led to greater awareness of the importance of social investment issues and presents a real opportunity for schemes to start doing more in this area.

Q1: 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?

Nest views social issues as important to a well-functioning economy and has been prioritising certain social issues within its Responsible Investment policy and approach for many years. This is linked to our strong sense of social purpose, our efforts to understand the issues that matter most to our members and most importantly our investment belief that integrating social as well as environmental and governance considerations into the investment management process helps to improve long-term risk adjusted returns.

We do not separate out Social issues as distinct from E and G. Nest's approach to managing social risk and opportunities are framed within our holistic approach to managing financially material ESG issues. We see close linkages and inter-connections between the 'E', 'S', and 'G.' For example managing climate-related risks and opportunities impacts on, and is influenced by, wider environmental issues, governance and social factors. For example, our approach to managing climate change which we set out in detail in our climate change policy describes the need to be mindful of the impacts of the climate transition on workers, local communities and wider society and for companies to have strong boards to support and steer their companies through the climate transition. We also push for better workforce diversity within companies which we promote through seeking to influence strong governance structures of investee companies.

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Q2. 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, to both parts of the question. Nest has a **voting and engagement policy** which covers specific social factors such as diversity, workforce matters, modern slavery and bribery and corruption. We encourage improved disclosure by companies on these issues so we can more effectively factor them in to our voting and engagement decisions over time.

We position our expectations in a governance and board context. In our view it is the board who should set and oversee policies on social issues particularly those that are deemed to be material to a company's strategy and long-term performance. We demonstrate how we expect corporate boards to manage social issues drawing on the UK Corporate Governance code where relevant and set out how we hold board directors to account on the management of different social issues.

Q3. 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?

We have developed policies and work streams on a range of social issues. These include:

- diversity,
- cyber security,
- health and obesity,
- human capital and
- workforce (which encompasses the real living wage, insecure work, working conditions and health and safety practices).

These issues were decided in line with our internal prioritisation framework which encompasses three core inputs; financial materiality to our investments, member characteristics/values and the availability of codes and standards to support and add value to our objectives. We also assessed our sector exposures and identified the likelihood for increasing sector specific risks and possible regulation. So for example we selected workforce as a key theme due to compelling financial evidence showing that in general companies that consider carefully their wage and benefit structures and take into account things like the real living wage, and companies that invest in their workforce by offering secure employment generally leads to greater workforce engagement, improved productivity, reduced staff turnover and may improve overall competitiveness[1]. We also looked at the common characteristics of our membership who are predominately on low to middle incomes and all part of the UK workforce.

We are founding signatories of the Workforce Disclosure Initiative[2] (WDI). Since 2017, we have reached out as part of a growing coalition of investors to ask hundreds of companies globally to respond to the WDI's annual survey, which asks for detailed information on how companies manage their workforce, including contractors. This initiative is helping us to enrich our understanding of company practices on a range of workforce-related issues including on our own areas of focus. We are seeing promising incremental improvements each year in terms of disclosure.

We use the UN Global compact principles as a global framework to help us identify and manage human rights, labour and anti-corruption controversies across our portfolio. Where there are serious breaches of these principles, we will decide on an escalation strategy that may include voting actions, engagement or divestment.

Other initiatives we are actively involved in are ShareActions' Healthy Markets Initiative and the Food Foundation, which seek to address the material impacts of obesity and health risks posed by the UK retail and global food manufacturing industries. Such companies are often the gateway for consumers' purchasing decisions, and without sound strategies to increase the sales of healthier products, systemic negative health and economic impacts will permeate investor and societal outcomes.

We are also signatories to the Farm Animal Investment Risk Return (FAIRR) initiative, which looks at both the social and environmental impacts of the animal protein value chain. Antimicrobial resistance, health risks to humans through animal meat processing work practices and infection transmission, are all areas that continue to emerge as important for investors to factor into investment decisions.

In 2020 we started a collaborative engagement with other asset owners and one of our fund managers to tackle the risks of cyber security, which we view as an issue that can have serious social impacts on people's data, privacy and finances. We have spoken to the leadership of companies globally within the most exposed sectors.

Diversity is a key social issue and we have an engagement programme that seeks to address both gender and ethnic inequalities at companies. We are proud to be co-chairs of the 30% Club UK Investor Group, which is catalysing the financial industry's role on tackling these issues.

Some of the more established standards such as the ILO are considered in our engagements in particular where there are concerns about freedom of association within investee companies.

Q4. 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?

The WDI, FAIRR, and investor initiatives like Shareaction's living wage, good work and healthy markets coalitions and collaborative engagement groups such as the one led by NZ Super to seek better controls by social media companies to address harmful content, as well as UNI Global Union's

[1] "The case for good jobs: Better pay and more opportunities. Your workers want those things. So should you." Harvard Business Review, June 2020

[2] An initiative set up to drive better disclosure on issues relating to workforce by companies globally

facilitation of investor action on the treatment of workers by companies such as Amazon have been invaluable in helping us address key and emerging risks and opportunities across our portfolio.

Where we have undertaken direct or collaborative engagements with companies on social issues we have been able to build up a good understanding on companies approaches to managing social issues, how well they're doing and how issues affect the strategic direction of the business. At present, relying on third party ESG data alone is not enough for investors to get a clear picture of companies' social policies, practices performance and plans. We remain a long way still from having robust data in this respect from investee companies, in part as data providers report on issues in very different ways. Data provided by ESG data providers is often backward-looking, or not decision-useful. The data shared by different ESG providers can often contrast, and they can provide limited data in some circumstances on areas such as supply chain conditions, impacts on local communities, and contingent workers.

Furthermore, many of the social risks prevalent in our portfolio are grounded by geography. As a UK based investor, we have a better view of what is happening in the UK market and what we can feasibly expect of UK companies. The regulatory and reporting frameworks for social issues in the UK are generally more progressive than other jurisdictions. That said, the availability of good quality, consistent data on material social issues is still lacking amongst UK companies and trying to achieve this at a global level even in key markets is an even bigger challenge.

Q5. 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?

In addition to voting and engagement with companies highlighted in question three above, engagement with regulators like the Financial Reporting Council (FRC) forms a key part of our approach. Whilst coverage of social issues in the UK Corporate Governance Code has recently increased, we believe the FRC could be clearer on where and how companies report on this information. We have also engaged with the PLSA to help determine the most meaningful social issues to investors and how they can be factored into pension schemes' voting decisions and engagement activities.

Q6. If this is delegated to asset managers, how do you ensure and monitor that they manage the risks and opportunities associated with social factors?

Nest acts upon social factors both directly and through its fund managers. We regularly discuss and engage with our managers on social factors to understand how they are being addressed in the portfolios managed for us. We set out expectations on ESG in our selection process and expect appointed managers to periodically report on how they have incorporated social factors in the investment process and progress on engagement and what outcomes have been achieved.

We generally expect appointed fund managers to exercise our voting rights in accordance with their own well thought-out and documented voting policies and to engage with companies to drive behavioural change and reduce long term investment risk. We meet with our fund managers annually to discuss updates to our voting policy including on social matters and key differences with our fund managers' policies. We use these discussions to encourage our fund managers to develop and improve upon their policies where necessary to ensure they endeavour to vote in the long-term interests of their clients.

Despite the positive engagement with managers, there is a lack of clear strategic focus by managers on social issues. Fund managers are actively working on rolling out climate-related investment strategies and stewardship approaches demanded by clients. This is being driven by the regulatory implementation and reporting requirements with the need for schemes to acquire robust climate data from managers. This has meant there has been relatively less focus and capacity by managers to consider data on social factors and address it at a strategic level. It is also perhaps more difficult for managers to demonstrate the impact of investor stewardship over a certain period of times, with 'S' manifesting very differently in companies and markets. Our experience has been that managers are addressing social issues on a reactive and ad-hoc basis. The development of clearer and more consistent expectations and standards on climate change makes it easier for managers to carve out a clearer and repeatable strategy and approach.

Q7. (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.

We have recent examples of our engagements on social factors in our latest **Responsible Investment Report**, where we outline the actions and outcomes of our engagements on human capital, diversity, cyber security and obesity (pages 17-21).

A couple of further examples of our work to date include strategic engagement projects focussing on culture and conduct in UK banks since the financial crisis and the examination of employment strategies including the reward and progression with select large UK companies. Details of these projects and the outcomes can be found in our **2016 Responsible Investment annual report**.

Our fund managers also undertake stewardship activity on a range of social issues including on diversity, cyber security and human rights issues and update us on activities and outcomes via their quarterly investment reporting.

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