RE: Consideration of social risks and opportunities by occupational pension schemes

BlackRock\(^1\) is pleased to have the opportunity to respond to the call for evidence “Consideration of social risks and opportunities by occupational pension schemes”, issued by the UK Department for Work and Pensions (“DWP”).

BlackRock supports a regulatory regime that increases transparency, protects investors, and facilitates responsible growth of capital markets while preserving consumer choice and assessing benefits versus implementation costs.

We appreciate the call for evidence was primarily and mostly addressed to pension fund trustees, their advisers, pension scheme members and beneficiaries. As an asset manager of pension schemes with around 10 million members in the UK, BlackRock welcomes the DWP’s information-gathering exercise and take this opportunity to share our current approach towards the Social (‘S’) in Environmental, Social and Governance (‘ESG’). As with the DWP’s climate-related governance and reporting requirements and broader expectations relating to climate change, we will work with and support pension scheme clients in their efforts to take social factors further into consideration.

We would be pleased to contribute to the thinking of the DWP on any issues that may assist in the final outcome.

Introduction

As a long-term investor on behalf of our clients, BlackRock seeks to promote sound corporate governance and sustainable business practices aligned with sustainable financial performance. Many social and environmental factors in a company’s business model have longer-term implications for performance. For instance, a company with a reputation as having poor employment practices may still be able to attract employees in the near term but may have difficulty attracting the most talented workers and incur greater hiring expenses over time. Accordingly, BlackRock seeks to understand how well material social and environmental factors are managed at the companies in which we invest on behalf of our clients.

The ‘S’ is an area of ESG, or sustainability, that has gained prominence in the past year. Underneath the ‘S’, however, lies many factors and issues that can be ‘labelled’ as such leading to definitional challenges (we further explore this in the next section).

We outline below how we view the financial materiality of ‘S’ factors, engage with investee companies on related topics and offer investment solutions and products to meet the sustainable investing objectives of clients as they relate to social issues. We also explain the role shareholders play through stewardship to encourage companies to identify their key stakeholders and explain how they take these stakeholders’

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\(^1\) BlackRock is one of the world’s leading asset management firms. We manage assets on behalf of institutional and individual clients worldwide, across equity, fixed income, liquidity, real estate, alternatives, and multi-asset strategies. Our client base includes pension plans, endowments, foundations, charities, official institutions, insurers and other financial institutions, as well as individuals around the world.
interests into consideration in business decision-making. Finally, to further reinforce the integration of social factors by pension schemes and the broader investor community, we recommend policymakers help accelerate companies’ reporting on relevant social factors. Asset owners and asset managers are limited in what they can do to reinforce social factors in their investment processes given the current limitation of the relevant data provided by companies.

**Defining the ‘S’ as a financially material factor in investments**

BlackRock’s investment conviction, grounded in research, is that not only climate change but also broader sustainability risks are investment risks. The integration of material ESG considerations in investment processes and analysis can help build resilience in asset owners’ portfolios. We believe that companies with sustainable business practices and a sound approach to considering their key stakeholders can deliver better long-term, risk-adjusted returns, making them a better investment than their less-well managed peers.

As pointed out in the call for evidence, social factors can mean different things to different people. Some will understand ‘social’ to mean issues related to the workforce or human rights issues, others will interpret it more broadly to cover all stakeholders. BlackRock believes the focus should be on social issues or impacts that are within a company’s control to manage. A broader concept including all stakeholders is unlikely to have sufficient focus, would be particularly challenging for companies to manage and for investors to assess a company’s effectiveness in managing business-relevant social issues. As pension schemes, asset managers or companies think through their approach to the ‘S’ in ESG factors, we believe they should seek to articulate the relevance to company (and thus portfolio) performance of the issues they identify.

BlackRock considers the ‘S’ in this context to mean a company’s impact on, and responsibilities to, the people it depends on to create long-term value – what we have termed its key stakeholders. We believe it is important for investors to understand how companies manage social risks and opportunities relating to their key stakeholders. In our experience, companies are more likely to meet their strategic objectives and deliver long-term value for their shareholders when they build strong relationships with their key stakeholders (which should be defined by the companies themselves but are likely to include employees, customers, suppliers, and the communities in which they operate). Poor relationships with their key stakeholders may create adverse impacts that expose a company to legal, regulatory, operational and reputational risks and jeopardise their social license to operate. Advocating for the adoption of responsible business practices in this respect is therefore an important component of our ability to look after our clients’ assets. In keeping with this perspective, as well as expecting companies to address workforce needs and expectations, we expect them to mitigate adverse impacts on other key stakeholders that could arise from their business practices.

We agree with the DWP that “[t]here is no single “right” way to consider social factors but there are several distinct approaches available” (page 14) for pension schemes and other asset owners to express their investment interest in the ‘S’, from screening

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to tilted funds, social impact investing and stewardship as outlined in the call for evidence. Further, asset owners, including pension funds, have their individual ESG investment philosophy, which can be influenced by the priority issues highlighted by their members. This in turn creates a plurality of potential philosophies for asset managers to support pension schemes on.

Below we provide an overview of three focus areas at BlackRock pertaining to the ‘S’ from an investment perspective:

- Stewardship engagement with companies on their social issues
- Research and investment framework on stakeholder considerations
- Investment solutions responding to asset owner social investing preferences

### Stewardship engagement with companies on their social issues

Stewardship is the first area where BlackRock focuses on the social issues of companies and their approach to managing their key stakeholders to create long-term value. As a long-term, minority shareholder in public companies on behalf of our clients, we engage in direct dialogue to provide feedback to board directors and executive management. We also vote at company shareholder meetings and may vote against management to signal concerns about a company’s governance or business practices. But it is the responsibility of boards and executive management to determine the appropriate strategy and course of action to best serve the interests of long-term shareholders and other stakeholders.

As the call for evidence notes, there have been several high-profile cases recently of UK companies that lost significant value as a result of negative social impact, with the role of shareholders, in particular their engagement and voting as a means of addressing such issues, debated. Added to this are the COVID-19 pandemic and the protests surrounding racial injustice in the US, the UK and elsewhere which underscored the importance of social issues and a company’s commitment to serving all of its key stakeholders.

These recent events deepened our conviction that companies need to demonstrate a holistic approach to their key stakeholders. BlackRock’s engagement priorities specify our expectations around how companies manage their impacts on people. Our expectations include that companies:

- Demonstrate a robust approach to human capital management (how they consider the interests of their workforce) and provide shareholders with the necessary information to understand how it aligns with their stated strategy and business model.
- Disclose actions they are taking to support a diverse and engaged workforce and, (recognising that accepted standards and norms of corporate governance differ between markets) an appropriate demographic profile of its workforce, where allowed by the local jurisdiction.
- Provide evidence of board oversight, due diligence, and remediation of adverse impacts on people arising from their business practices. Specifically, we ask companies to enhance disclosures on the due diligence steps that they are taking around their supply chain. The responsibility is with companies to make these assessments and confirm that their contractors have appropriate policies and practices in relation to their impacts on people. It is not the role of minority

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investors, either legally or practically, to dictate a company’s business practices, but to advocate for the proactive management by companies of business relevant social issues, and holding them accountable for their approach towards and reporting on their due diligence.

- Report on their material and business relevant ESG risks and opportunities. We initiate many of our engagements because a company’s disclosures do not provide the information necessary for us to assess the quality of its governance or business practices. We recommend companies review their reporting in light of the changing expectations of their investors and other stakeholders.

Until a global set of standards is established, which the IFRS Foundation is currently working on, we will in our engagements with companies continue to advocate for corporate sustainability reporting aligned with the four pillars of the Task Force on Climate-related Financial Disclosures (TCFD) framework, supplemented by sector-specific and financially-material metrics. Such metrics should be relevant to investment decision-making in that they help explain how a company creates value and manages risk.

The onus is on companies to have the appropriate reporting to meet the legal and practical expectations on them – and, as a corollary of that, develop the business practices that underpin them. This is the responsibility of boards and executive management as a matter of law and practice. Minority investors, such as asset owners and asset managers, have a stewardship role to play advocating for the proactive management by their investee companies of business relevant social issues, and holding them accountable for their approach in this respect. But this does not alter that the responsibility for managing these issues lies with the boards and management of companies. It is not the role of minority investors, either legally or practically, to dictate a company’s business practices. As part of their public policy efforts, investors can highlight to policymakers how their expectations of companies might be addressed through possible policy actions, especially around sustainability corporate reporting.

**Research and investment framework on stakeholder considerations**

Our second focus area is on deepening our research on the financial materiality of key stakeholder considerations and setting out an investment framework to be used by BlackRock portfolio managers.

As part of our ESG risk analytics tools available on Aladdin, our core risk management and investment technology platform, we have developed a proprietary materiality-based ESG assessment capability leveraging a research-based quantitative and qualitative methodology to provide a backward- and forward-looking assessment of material ESG key performance indicators. We built these to assist BlackRock portfolio managers in their ESG investment analyses.

From an investment research perspective, it is most challenging to invest in the ‘S’ out of ESG due to lack of data, poor quality data, and complex macro trends. We see the potential benefit to developing unique social insights that incorporate forward-looking macro themes (such as automation, demographics, and data privacy) which impose considerable risks and opportunities to corporate performance (and so are financially material) based on multiple data sources.
To build a research and investment framework focused on stakeholder considerations, we have focused on financially material considerations and believe that a company’s management of the following five pillars is financially relevant:

1) Culture, creating a work environment that promotes employee satisfaction, inclusion and diversity, and attractive benefits.
2) Talent management, offering career development and skills training for employees, as well as managing hiring and retention.
3) Workers’ rights, ensuring employees’ basic rights through positive labour relations, social working conditions and fair wages.
4) Customer relations, focusing on customer welfare and satisfaction, through product quality, data privacy and fair disclosures/marketing.
5) Community relations, operating as a good corporate citizen that protects human rights, is accountable to local community and offers access to basic needs.

BlackRock relies on multiple sources, including the data disclosed by companies and looking at alternative unstructured sources (such as Glassdoor) to populate this framework. However, the lack of high-quality, relevant and comparable data provided by companies remains an important impetus to furthering the investment framework.

**Providing investment solutions responding to client social investing preferences**

The third investment area in which BlackRock takes social issues into consideration is investment solutions. Historically, at the industry level, the first wave of ‘S’ strategies targeted a single theme such as gender diversity at the company level and investment solutions leveraged only one source of data. A number of ‘S’ focused investment strategies have launched in recent years, notably strategies that allow asset owners to align their capital with specific outcomes, such as the UN Sustainable Development Goals.

BlackRock’s offering of investment solutions takes into account the varied objectives of investors, some seeking to avoid companies involved in controversial business activities, others seeking to invest in specific companies to advance social outcomes. We enable asset owner clients to implement their advancing social objectives through strategies that invest in companies which demonstrate better management of social risks on a standalone basis or as part of their broader ESG performance. We have also developed strategies that capitalise on long-term sustainability trends, such as changing consumer behaviour, nutrition and health. Further, our impact funds seek to address ‘S’ related outcomes in addition to environmental concerns, including education, affordable healthcare, affordable housing and access to financial services.

We have seen interest from some UK pension schemes, in particular Defined Benefits and local government pension schemes, in social impact investing. Social impact investing is made with the intention to generate positive, measurable social and environmental impact alongside a financial return. We have found that our clients are particularly interested in demonstrating their contribution to the local community, and hence prefer to invest locally.

To reiterate, we agree with DWP that investors have an array of ways to approach social factors as investment considerations, including exclusionary screening on human rights controversies.\(^5\) Importantly however, interest for standalone ‘S’

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\(^5\) Having said that, paragraph 6, page 10 of the call for evidence seems to suggest that targeted stewardship is the only approach possible to adequately address social factors. While we agree that engagement on company’s due diligence and reporting on the
strategies has not yet received the same momentum as climate ones. One of the reasons for this, further explained below, is the limited relevant data provided by the underlying assets.

Challenges associated with further integrating the ‘S’ and proposed solutions

In our view, the cause of the limited reporting of social factors in trustees’ Statement of Investment Principles (as outlined in Annex A of the call for evidence) as well as more broadly of investors’ ability to take into account social factors more systematically resides in the challenges in isolating a single ‘S’ factor, particularly across sectors, and thus in measuring it in terms of financial impact.

This uncertainty is linked to inadequate coverage and quality of the data investee companies provide on their relevant ‘S’ issues. The ability to take an enhanced or more proactive approach towards social factors depends on better and more consistent disclosures from investee companies. We believe that until the quality of the data improves, pension schemes will be less likely to more systematically address social factors in their investment processes. While Section 172 of the Companies Act requires UK companies to report to a certain degree information on their approach towards stakeholder engagement, recent work by the likes of the Financial Reporting Council shows that numerous improvements could be made to these disclosures. This type of reporting is also not required or common on a more global scale.

While we welcome the Government’s accelerated efforts to make climate-related reporting mandatory across the UK economy, we hope this will not lead companies to deprioritise their broader sustainability reporting efforts. Our interim expectation, until a global set of sustainability reporting standards is set out over the next few years, potentially by the IFRS Foundation, is that companies will continue disclosing their broader sustainability considerations that are material to value creation. The UK Government, in complementing investors’ asks, could signal expectations that UK companies continue their reporting efforts not just on climate but broader sustainability, including social, considerations relevant to their business.

Unlike climate change, industry-specific metrics for companies to deepen their understanding of social considerations remain quite limited. This could be an area for the relevant international organisations, including the IFRS Foundation, to look at. We support the IFRS Foundation playing a central role in setting globally accepted sustainability reporting standards, given its domain expertise and the relationships it has with public policy makers and market regulators, which are essential to handling of human right issues is primordial, and per the above, BlackRock has set out expectations on companies to address these, we do not believe stewardship should be the only recognised approach towards addressing social factors, including human rights issues, as an investment issue. We also do not believe that stewardship alone has the power to prevent potential human rights failures by investee companies.


establishing a credible reporting system that achieves regulatory recognition and adoption.

Until a global standard coupled with industry-specific metrics are not established, it would remain a challenge for investors to be able to do anything more structured around investment products and solutions at scale that consider social factors.

**Conclusion**

Companies, investors and governments all have a distinctive role to play to advance social issues. The role of companies is to have policies and practices that ensure that their impacts on people can drive their long-term performance and ability to create value. Policymakers provide a legal framework to protect people and promote responsible business practices and can support the formation and execution of the relevant global standards created by intergovernmental organisations. Finally, investors, including BlackRock, evaluate, and engage with, companies on their impacts on people to encourage them to integrate sound business practices that benefit relevant stakeholders, including clients on behalf of whom we invest, over the long term.

To support investors in further taking social impacts into consideration in their investments, the limitations of the existing underlying data need to be addressed. BlackRock expects investee companies to disclose adequate information, including on how they have determined their key stakeholders, considered their interests in business decision-making and due diligence. In addition, BlackRock recommends policymakers, including the UK Government, signal to companies the need for enhanced reporting on these considerations while a global baseline reporting standard on which jurisdictions can build on has been established.