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FAO: Luba Nikolina, Chair of the Taskforce on Social Factors ("TSF")

Submitted by e-mail to: consultation@taskforceonsocialfactors.co.uk

Dear Ms Nikolina,

CFA UK's Response to the Consultation on the draft guide from the Taskforce on Social Factors

The provision of education opportunities to investment professionals in the rapidly developing field of ESG investing has been a strategic focus at CFA UK for some years. In 2019, CFA UK addressed the UK investment sector's skills gap by developing the Certificate in ESG Investing[1]. Noting the specific challenges presented by the 'S' within ESG Investing and in support of the DWP's work to encourage the more widespread application and integration of social factors by UK pension schemes, CFA UK's Pensions Expert Panel published a report earlier this year entitled "Social investing by UK pension schemes at home and overseas: opportunities and challenges"[2]. The CFA Society of the UK ('CFA UK')[3] therefore welcomes the opportunity to comment on the Taskforce on Social Factors (TSF) draft guide ('the Guide').

We believe the Guide will be helpful for pension scheme trustees to better understand social issues and how they could influence pension investments. Overall, the Guide helps to promote an understanding of social factors, in particular modern slavery and the complex nature and interaction within/between factors. It also provides an important source of impetus for trustees to act. This is important as, at this stage, the Taskforce on Inequality and Social-related Financial Disclosures ('TISFD') is not yet available and social data is not as fully developed or of as high calibre as E or G data. The Guide is most helpful in supporting the identification of social factor risks through assessing materiality and salience of social exposures and risks.

We are pleased to provide responses to the TSF Consultation questions in Appendix II.

In addition, we have seventeen specific recommendations for the Taskforce, which we lay out below in terms of what our members perceive to be (a) identified gaps, (b) qualifications to and (c) presentation suggestions for the Guide.

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[1] The Certificate in ESG Investing is now run globally by CFA Institute and has had over 47,000 registrations since launch in 2029: https://www.cfainstitute.org/en/programs/esg-investing

[2] Social Investing by UK pensions schemes at home and overseas: opportunities and challenges (Jan 2023): https://www.cfauk.org/professionalism/ethics/reports-and-whitepapers#gsc.tab=0

[3] CFA UK is a professional body representing over 11,000 investment professionals in the UK. Appendix I contains a summary of the mission, purpose and activities both of CFA UK and that of our umbrella organisation, CFA Institute.

A) IDENTIFIED GAPS

1. SCHEME MEMBER ENGAGEMENT: the Guide makes several references to the importance of engagement with underlying scheme members but does not develop any detail on this topic. This is a particularly challenging area a) generally, as scheme members currently show low levels of engagement and b) in relation to social factors due to the wide range and political nature of the topics. We think that the Guide would be well served if some examples of scheme best practice on member engagement on social factors could be illustrated and described. On the other hand, the conclusion might be that whilst membership engagement on social factors sounds good and worthy, but is in reality not practical. We have also had member feedback to indicate that in the case of DC schemes, where members have some say in how funds are allocated, that such engagement may also prompt scheme beneficiaries (who are not investment professionals) to make sub-optimal investment decisions due to the over-emphasis of social factors above other important investment considerations.
2. STEWARDSHIP CODE & UK CORPORATE GOVERNANCE CODE: the Guide includes reference to the Stewardship Code within the 3-tier framework but does not reference the UK Corporate Governance Code. We believe that both should be given more prominence. Specifically:
    a. We believe that the consideration of applying for signatory status under the Stewardship Code should be an additional recommendation for 'Trustees' in Chapter 4;
    b. We believe that the consideration of applying for signatory status under the UK Corporate Governance Code should be an additional recommendation for 'Businesses & Employers' in Chapter 4;
3. REGULATION OF ESG RATINGS & DATA PROVIDERS: this legislative reform is already underway but as yet is incomplete. We believe that an additional recommendation for both 'Regulators' and 'Government' in Chapter 4 should be "the imminent, effective and proportionate regulation of ESG ratings and data providers". For ESG ratings and data providers, transparency of rating methodology and any act of data aggregation or manipulation is key.
4. HUMAN CAPITAL: In its recent agenda consultation, the International Sustainability Standards Board ('ISSB') sought opinions on the relative priority for new research work on disclosure standards for both (i) Human Rights and (ii) Human Capital. The Human Rights agenda is well-served in the Guide through Appendix 3; we would recommend the development of a new Appendix 4 on Human Capital to give these aspects equal weighting. The appendix would usefully include a wide range of possible metrics for quantitative analysis, more extensive than those provided already in Chapter 2 of the Guide.
5. SECTOR ALLOCATIONS: we enjoyed the detail and practical approach of Appendix 2. The Effective Integration question-set focused on investments in individual companies. We would recommend building on this with a complimentary section on sector allocations.

We note that elsewhere the Guide makes an interesting observation that by only allocating to sectors that have strong Social positives, pension schemes could deprive other sectors (with negative social issues) of capital thus potentially perpetuating and extenuating the social problems within these sectors. Thoughts on how to best navigate this conundrum would be welcome. We also note that for many pension schemes, corporate assets represent a very limited part of the overall portfolio. Government bond holdings and insured assets are typically far higher in mature DB schemes. Some thoughts on how to integrate social factors into sovereign bond holdings and due diligence when selecting an insurance provider would be welcome.

6. CORPORATE SPONSORS: the recommendations in Chapter 4 address the key elements of the ecosystem (Trustees, Consultants, Asset Managers, Government, Regulators etc) and whilst this includes a section for 'Business & Employers' we note that there are no specific recommendations for businesses specific to their role as pension scheme sponsor, whether DB or DC. Corporate sponsors are being increasingly required to report on their own sustainability and whilst pension schemes are run for the benefit of the employees and not the corporate sponsor, corporate sponsors should be rightly concerned if their pension scheme was making no effort to invest sustainably and actively consider social factors in its decisions about investments.
7. PRIVATE ASSETS: the UK Government used this year's Mansion House speeches to inter alia promote the idea that UK pensions funds should be following the Yale model more closely and allocating more to UK private equity and UK infrastructure assets to boost UK economic growth and pension scheme returns. Social data collection, however, is generally more difficult in private assets than public assets and so the development in Section 2 of some thoughts on the particular challenges of obtaining good social data for private asset investments could be useful and supportive for this element of current government policy.
8. SOCIAL INVESTMENT SKILLS & KNOWLEDGE: whilst considerable progress has been made, investment professionals' knowledge and understanding of social factors is still in a stage of development. Investment in staff training and exam curriculum work is an important antidote to this. We believe that pension schemes interested in mandating asset managers with strong social investment pedigree should also be asking their asset managers for evidence of the degree to which such investments are being made. Whilst we are keen to promote our own exam qualifications in this area, we are far from being a sole provider and indeed the sector is best served by having a marketplace of good providers of such resources.

B) QUALIFICATIONS:

1. RECOMMENDATIONS FOR REGULATORS & GOVERNMENT: we do not feel overly strongly about it but would like to raise the question whether this document, which is aimed at trustees, should contain recommendations for Regulators and/or Government.
2. STEWARDSHIP CODE: as mentioned under A2 above, we are surprised by the low level of reference within the Guide to the FRC's Stewardship Code. That said, we detect from

members that many trustees see the Stewardship Code as currently working better for asset managers than asset owners, with a limited natural audience for the asset owner reports. Many asset owners complain that whilst becoming a signatory under the stewardship code may be worthwhile in the first instance it duplicates other reporting obligations and is resource intensive to maintain every year.

3. TISFD: it is more politically challenging to develop than both TCFD and TNFD, especially on a global scale, but, if recommendations for ‘Government’ are to be included in the Recommendations chapter, we would like recommendation 13 in chapter 4 to be expanded to explicitly call for government support for the publication of a global TISFD.
4. ‘ARRANGING’ SOCIAL DATA: we agree with the tenet in the last paragraph of page 9 that providers of social data could make such data available in a more user-friendly format. We would wish to caveat that such ‘processes of arranging social data’ need to be transparent, so that users, should they wish, can check back to the underlying data.
5. SOCIAL FACTOR MODELLING, REPORTING & DISCLOSURE: whilst the guide is useful for strengthening social considerations in engagement and voting, we note that how to model, report and disclose social factors is still at an early stage and the Guide could possibly expand on this. Reference could also be made to the other modelling and reporting that pension funds are already obliged to do in their Implementation Statements. Larger schemes that are already required to publish a climate report, could consider expanding this into a Sustainability report and include modelling and disclosures on social factors in this report.
6. MATERIALITY ASSESSMENT FRAMEWORK: as discussed above, we find this a useful resource for trustees. We would suggest additional comment or guidance be given around the recommended periodicity or frequency of review at each level. We are unclear whether this is meant to be ‘ongoing’ (which might not be practical), or whether parts are subject to say annual and others to 3-yearly assessment.

C) PRESENTATION:

1. SALIENCE/MATERIALITY: we enjoyed the insights offered by the salience and materiality section on page 7 and would suggest that this could be made still more powerful by the insertion of a worked-up example of a “salience/materiality grid/mapping exercise” (as referenced later on page 8) for say one particular industry sector, such as telecoms or AI. Relative to say Climate, for example, Social factors are very fast moving and reputational risks associated with social factors can become material within a comparatively short timeframe. Further, we wonder if this could provide the foundation for a LEAP-style framework as developed under TNFD.
2. MODERN SLAVERY APPENDIX: The tables in Appendix 3 are very useful. We believe it would be additionally helpful if it could be clarified who exactly the different materials are primarily designed in mind for i.e. which are for trustees and which for asset managers etc.
3. CASE STUDIES: the case Studies provided provide useful insights, albeit we note they tend to be qualitative in nature and we wonder whether one or more quantitative-

based examples could be included alongside. As the TSF develops, we could see the number of Case Studies growing.

In line with our Society's purpose, we aim to highlight relevant issues to help the investment community to serve its stakeholders well and to build a more sustainable future. We will be sharing this response with our members and subsequently posting it publicly on our website.

Should any of the contents of this letter require further clarification we would be delighted to engage further and seek to provide it.

Yours sincerely,

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CFA Society of the UK

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With thanks to contributions from:

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APPENDIX I: About CFA UK and CFA Institute

CFA UK serves over eleven thousand leading members of the UK investment profession. Many of our members work either managing investment portfolios, analysing and advising on investments, or in some form of investment operations and oversight role.

The mission of CFA UK is to build a better investment profession and to do this through the promotion of the highest standards of ethics, education and professional excellence in order to serve society's best interests. Many of our members work for Data Service Providers or are end users of their products and services.

Founded in 1955, CFA UK is one of the largest member societies of CFA Institute and provides continuing education, advocacy, information, networking and career support on behalf of its members.

CFA UK has pioneered the development of ESG-related examinations for investment professional in recent years, specifically the Certificate of ESG Investing (now run by CFA Institute), the Certificate of Climate Investing and the Certificate of Impact Investing (currently under development).

Most CFA UK members have earned the Chartered Financial Analyst® (CFA®) designation or are candidates registered in CFA Institute's CFA Program. Both members and candidates attest to adhere to CFA Institute's Code of Ethics and Standards of Professional Conduct.

For more information, visit www.cfauk.org or follow us on Twitter @cfauk and on LinkedIn.com/company/cfa-uk/.

CFA Institute is the global association for investment professionals that sets the standard for professional excellence and credentials.

The organisation is a champion of ethical behavior in investment markets and a respected source of knowledge in the global financial community. Our aim is to create an environment where investors' interests come first, markets function at their best, and economies grow.

It awards the Chartered Financial Analyst® (CFA) and Certificate in Investment Performance Measurement® (CIPM) designations worldwide, publishes research, conducts professional development programs, and sets voluntary, ethics-based professional and performance-reporting standards for the investment industry.

There are nearly 200,000 CFA® charterholders worldwide in more than 160 markets. CFA Institute has ten offices worldwide, and there are 160 local societies.

For more information, visit www.cfainstitute.org or follow us on Linkedin and Twitter at @CFAInstitute.

APPENDIX II: Responses to Questions

Q1. Do you agree the report will be helpful for pension scheme trustees to better understand social issues and the impetus to act on them?

Yes. We believe the Guide will help pension scheme trustees to better understand social factors and how they could influence pension investments. Overall, the Guide helps to promote an understanding of social factors, in particular modern slavery and the complex nature and interaction within/between factors.

It could also provide an important source of impetus for trustees to act, especially if the DWP actively promotes it. This is important as, at this stage, the Taskforce on Inequality and Social-related Financial Disclosures ('TISFD') is not yet available and social data is not as fully developed or of as high calibre as E or G data. The Guide is most helpful in supporting the identification of social factor risks through assessing materiality and salience of social exposures and risks.

Q2. For scheme trustees, does this report adequately address and provide a way forward for your scheme circumstances?

CFA UK does not act as a trustee on any pension scheme directly, though many of our members do.

Overall, we find that the Guide will provide address and provide a way forward for most schemes. The degree to which this is the case, however, will depend on how far the scheme concerned has already attempted to integrate social factors in their investment decisions.

For example, one such member highlighted that a major UK pension fund, which they act as a trustee of, considers ESG factors in all of their investments, but only where they can be 'considered to be financially material'. The Guide's observations around salience and materiality may possibly pre-empt further thinking on this as social factors and reputational risks associated with them are very fast moving. Please see our recommendation C1 in the covering letter on how to possibly further articulate this through an illustrative example.

Many smaller schemes have yet to integrate social factors at all in their decisions. For such pension schemes, the Guide should prove a useful aide memoire and act as a source of impetus to start to consider this (where they have the resources to do so):

- We believe both the materiality assessment framework and the 3-tier framework for addressing social factors will prove helpful;
- The metrics provided are helpful (living wage, gender pay gap, accident rates, supplier payment terms, etc) are good starters, though we believe best

practice in this area extends much further in terms of the quantitative data analysed.

We believe the Guide is useful for strengthening social considerations in engagement and voting. However, how to model portfolios and to report and disclose on social issues is not covered in the Guide.

See our also recommendation B5 in the covering letter.

Q3. Do you see the proposed systematic materiality assessment framework for social factors as something you can practically implement in your portfolio?

On the whole, yes.

The Guide provides a clear, step-by-step process linking focus areas and available data sources. We conceive that this could provide the foundation for a LEAP-style framework as recently employed in the TNFD.

However, we think the Guide would benefit from additional direction as regards the recommended frequency or periodicity of review. It is unclear whether this is designed as an ongoing exercise, or say a 3-year review or whether indeed some aspects (e.g. sovereign risk) need to be reviewed less frequently than others (e.g. sector reviews). Please also see our recommendation B6 in the covering letter.

Q4. Do you believe the three-level framework for addressing social factors in pension portfolios provides useful developmental guidance (from a trustee perspective)?

Yes. The 3-tier framework builds knowledge of industry best practices and by providing different entry levels it caters for the wide dispersion in the degree to which social factors are already integrated by pension schemes in their investment decision making.

The 3-tier framework also interacts well with the Stewardship question-set in Appendix 2. Asset managers can also use the 3-tier framework to understand trustees' needs and help prepare themselves to serve their pension clients better.

We note that the 3-tier framework is entirely narrative/qualitative with no quantitative targets. As such it is a useful discussion rather than measurement tool.

Q5. Do you agree with the resulting recommendations for the pensions ecosystem?

Yes.

We agree with the recommendation for the three key elements of the pension system (trustees, consultants, asset managers).   We think that the corporate sponsor is a fourth key element that should be considered.

Some of our members commented that, as this is a report for pension trustees, it was beyond its remit to offer recommendations for government and regulators.

Please also see recommendations in our covering letter, specifically A1, A2, A3, A6, A8, B1 and B3.

Q6. Do you find the information in appendices practical and informative?

Yes. We found Appendices 1-3 useful and practical; we have the following suggestions:

- In Appendix 2, we enjoyed the detail and practical approach. The Effective Integration question-set provides a good focus on investments in individual companies. We would recommend extending this with a complimentary question-set on sector allocations. See also our recommendation A5.
- In Appendix 3, the table format is very useful. We believe it would be additionally helpful if it could be clarified who exactly the different materials are primarily designed in mind for i.e. which are for trustees and which for asset managers etc. See also our recommendation C2 in the covering letter.
- We found the Case studies useful, however, we noted that their main focus, perhaps indicative of current capability, is engagement/qualitative based rather than quantitative. As the TSF develops, we would hope to see more case studies following an approach similar to the piloted LEAP framework in TNFD. See our recommendation C3 in the covering letter.

Q7. Is there anything else that you would like to see covered?

Yes.

- EDUCATION & TRAINING: The importance of the acquisition of skills and knowledge in knowledge and understanding of social factors in investment throughout the entire UK pensions investment ecosystem. See our recommendation A8 in the covering letter.
- PRIVATE ASSETS: A distinction drawn between private and public assets, the specific challenges of social data collection on many private assets and how trustees might look for these challenges to be mitigated or overcome. This seems especially pertinent given the government's current goal of increasing the level of UK pension scheme investment in private equity and infrastructure assets. See also our recommendation A7 in the covering letter.
- HUMAN CAPITAL: We would welcome a fourth Appendix on Human Capital to counter-balance Appendix 3 on Human Slavery. See also our recommendation A4 in the covering letter.
- ENGAGEMENT WITH SCHEME MEMBERS: This is a challenging topic for many pension schemes generally and especially so on social factors. Examples of best practice could provide trustees with welcome insights on how to begin to navigate this difficult area. See also our recommendation A1 in the covering letter.