Principles for Responsible Investment

PRI RESPONSE

PENSIONS INVESTMENT REVIEW: CALL FOR EVIDENCE

September 2024

PRI Association
Registered office: 25 Camperdown Street
London, UK, E1 8DZ Company no. 7207947
T: +44 (0) 20 3714 3220 W: www.unpri.org E:info@unpri.org

ABOUT THE PRI

The Principles for Responsible Investment (PRI) works with its international network of signatories to put the six Principles for Responsible Investment into practice. Its goals are to understand the investment implications of environmental, social and governance (ESG) issues and to support signatories in integrating these issues into investment and ownership decisions. The PRI acts in the long-term interests of its signatories, of the financial markets and economies in which they operate and ultimately of the environment and society as a whole.

The six Principles for Responsible Investment are a voluntary and aspirational set of investment principles that offer a range of possible actions for incorporating ESG issues into investment practice. The Principles were developed by investors, for investors. In implementing them, signatories contribute to developing a more sustainable global financial system.

The PRI develops policy analysis and recommendations based on signatory views and evidence-based policy research. The PRI welcomes the opportunity to respond to the Pensions Investment Review call for evidence, led jointly by the HM Treasury, Department for Work and Pensions, and Ministry of Housing, Communities and Local Government.

ABOUT THIS CONSULTATION

The Chancellor of the Exchequer has announced a Pensions Review led by the first joint Treasury and Department for Work and Pensions Minister. The review aims to strengthen the UK's economic foundations, ensure better retirement outcomes, and leverage the significant potential of the pension industry to support national growth.

The review will have a number of phases, with the first stage and this call for evidence focused on driving scale and consolidation, the structure of the pensions ecosystem, increasing focus on value over cost, and encouraging investment into UK assets.

For more information, contact:

Margarita Pirovska	Nikki King
Director Global Policy	Senior Policy Analyst, UK & Switzerland
margarita.pirovska@unpri.org	nikki.king@unpri.org

KEY RECOMMENDATIONS

The PRI welcomes the Pensions Investment Review call for evidence, which presents an opportunity to further align the UK's pension system with broader economic and sustainability objectives. While the first phase of the review focuses on boosting investment, increasing pension pots, and reducing waste in the pension system, the PRI encourages incorporating sustainability considerations throughout the review. This review is an opportunity to ensure that upcoming pension policy development and reforms address the government's net zero commitments and align with the whole-of-economy transition, whilst also delivering better outcomes for pensioners.

The PRI has produced a number of analyses on pensions policy in the UK and other jurisdictions. Earlier this year we published a briefing on UK Pensions Policy detailing the state of play and highlighting areas that require further work to fully address today's complex challenges and opportunities. The PRI also published Progress and Priorities – Reviewing sustainability in key pensions systems this year, which identified 10 priorities that are necessary for a pension system to take sustainability considerations into account. The report was informed by industry research and practitioner interviews conducted in Australia, the UK, and the US to gather perspectives on the barriers to embedding sustainability in pension systems, as well as earlier PRI pension reports and the Legal Framework for Impact project.

As long-term investors, pension funds' ability to generate long-term value for their beneficiaries depends on the health and resilience of the environmental and social systems that underpin the economies they invest in. Therefore they have a responsibility to consider whether system-level sustainability risks are relevant to their ability to meet their legal obligations and objectives and, if so, how they can mitigate these threats.[1] This can be achieved by pursuing positive sustainability outcomes, as outlined in the summary report of the Legal Framework for Impact project.

Our response to this Pensions Investment Review is focused broadly on the topics of scale and consolidation, and investment in the UK. We set out below our recommendations which take into account our previous pensions research and analysis to date.

- **Encourage fund consolidation where there are benefits to the market,** whilst also properly considering the impacts of consolidation on sustainability objectives and strategies.
- Policymakers should **provide clear and consistent policy signals that give investors confidence and certainty to invest in sectors driving the UK's transition.**
- **ESG-related training should be provided to trustees and other key investment decision-makers and professionals,** enabling them to identify and take advantage of a broader range of investment opportunities.

[1] Freshfields Bruckhaus Deringer, PRI, United Nations Environment Programme Finance Initiative, Generation Foundation (2021), A Legal Framework for Impact: Sustainability impact in investor decision-making

DETAILED RESPONSE

SCALE AND CONSOLIDATION

In PRI's 2020 report, we highlighted that market fragmentation was the most significant structural barrier to successful policy implementation. In the UK, the occupational pension landscape remains fragmented, with a small number of relatively large schemes and a large number of smaller schemes. According to TPR's Annual report on UK defined benefit and hybrid schemes 2022, while the number of DB schemes is declining, over 5,000 remain, of which approximately 80% have fewer than 1,000 members.[2] The number of DC schemes is also falling and, more significantly, almost three-quarters of the assets in trust-based DC schemes are now held in master trusts.[3]

Larger funds are more likely than small funds to have the governance, resources, investment and stewardship expertise required to develop, monitor and report on sustainable portfolio strategies.[4] Smaller schemes can be market-leading sustainable investors, but the additional resources required to develop, implement and monitor sustainable investment strategies in the best interests of members and beneficiaries mean that scale is becoming more important. **The UK Government should encourage fund consolidation where there are benefits to the market, whilst also properly considering the impacts of consolidation on sustainability objectives and strategies.**[4]

Given the challenges of consolidation arising from diverse legal and membership structures in UK schemes, **policymakers should also encourage the pooling of investments or resources as well as collaboration, particularly in areas like stewardship activities.** Collaboration with other investors is likely both to reduce the costs and enhance the prospects of a successful sustainability outcome and therefore of achieving the goals of investors when investing for sustainability impact. It is possible to access some of the benefits of consolidation through co-operation, following the example of Australia where the Supers established a collective investment vehicle, the Development Australia Fund (now IFM Investors), in 1990 when the superannuation system was considerably smaller than today.[4] The Local Government Pension Scheme pools have also successfully created investment scale without a full administrative merger of the underlying schemes.

INVESTING IN THE UK

Pension funds and other institutional investors have an important part to play in financing green growth, supporting the UK Government's key priorities of increasing economic growth, facilitating the energy transition, and achieving net zero targets. As long-term investors, pension schemes are particularly susceptible to sustainability risks such as climate change but are also well-positioned to direct funds into green long-term productive assets[5] like infrastructure and housing stock. To

---

[2] TPR (2022), Annual report on UK defined benefit and hybrid schemes 2022

[3] TPR (2023), DC trust: scheme return data 2022 to 2023

[4] PRI (2024) Progress and Priorities: Reviewing Sustainability in Key Pensions Systems

[5] Thurley, House of commons (2021), Pension scheme investments and climate change

capitalize on this potential, **the UK government needs to provide clear and consistent policy signals, such as comprehensive sector roadmaps**, **that give investors confidence and certainty to invest in sectors driving the UK's transition**. There is a need for further granularity from the UK government, including a mapping of the investment required across sectors and regions to ensure that solutions are targeted towards investment gaps that need to be filled.[6] As the government continues to develop pension reforms, it is crucial to ensure alignment with its net zero commitments and the whole-of-economy transition, creating a cohesive strategy that leverages the ability of pension funds to support sustainable economic growth.[7]

To increase pension fund investment in the UK, it's also important to consider the role of trustees and fiduciaries, who are ultimately responsible for pension fund decisions. They play a central role in building sustainable investment portfolios and contributing to the development of a sustainable pension system that can effectively support the UK economy. While the government's response to the pensions trustees skills, capability and culture call for evidence noted that trustees are aware of the knowledge and understanding requirements expected of them, as set out in TPR's Code of Practice, there was a general acknowledgment that trustees would benefit from more guidance and training.[8] For trustees to have the right knowledge and understanding to invest in the full breadth of investment opportunities they need to have an understanding of environmental, social and governance (ESG) issues.[9] We recommend that **ESG-related training should be provided to trustees, as well as other key investment decision-makers and professionals** such as investment advisors, consultants and lawyers This would enhance their ability to understand and incorporate sustainability factors into their decision-making processes, enabling them to identify and take advantage of a broader range of investment opportunities within the UK market.

The PRI has experience of contributing to public policy on sustainable finance and responsible investment across multiple markets and stands ready to support the work of the Treasury further to develop pensions policy.

Please send any questions or comments to policy@unpri.org.

More information on www.unpri.org

---

[6] PRI (2024) Response UK transition Finance Market review

[7] PRI (2023) Investing for the economic transition: The case for whole-of-government policy reform

[8] UK Government (2023) Call for evidence outcome Pension Trustee skills, capability and culture

[9] PRI (2024) UK Pensions Policy