PRI RESPONSE

CP24/16: THE VALUE FOR MONEY FRAMEWORK

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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

An investor initiative in partnership with UNEP Finance Initiative and UN Global Compact

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 value for money framework consultation led by the Financial Conduct Authority (FCA).

ABOUT THIS CONSULTATION

The FCA is consulting on the detailed rules and guidance for a new value for money (VFM) framework for defined contribution (DC) workplace pension schemes. This framework is focusing on a broad array of factors including costs and charges, quality of services, investment performance and customer experience. The aim of the framework is to reduce the number of pension schemes that are delivering poor value as well as driving better value for money across the workplace DC market through greater scrutiny and competition on long-term value. The FCA is also working in collaboration with the Department for Work and Pensions and the Pensions Regulator to ensure the framework can be applied across all DC workplace pension schemes.

The feedback received during this consultation will be used to inform future legislative developments. This provides further opportunities to ensure alignment of pensions policy with the UK government's net zero commitments and the whole-of-economy transition, whilst also delivering better outcomes for pensioners.

PRI responds to the part of the consultation that is directly relevant for responsible investment.

For more information, contact:

Margarita Pirovska
Director Global Policy
margarita.pirovska@unpri.org

Nikki King
Senior Policy Analyst, UK & Switzerland
nikki.king@unpri.org

KEY RECOMMENDATIONS

The PRI welcomes the value for money (VFM) framework consultation on the detailed rules and guidance for the framework which moves the emphasis away from a focus on cost towards overall value. The FCA has stated that they "have considered environmental, social and governance (ESG) implications" however, the integration of ESG considerations into the proposed framework remains limited. This consultation provides an opportunity to enhance the emphasis on sustainability factors within the new VFM framework. By doing so, we can further align the UK's pension system with the broader economic and sustainability objectives of the UK government.

Pension funds are long-term investors and their ability to generate long-term returns relies on the performance of the markets and economies in which they invest. Sustainability factors such as climate change and biodiversity loss threaten the performance of the markets and economies on which they rely for financial returns. Therefore, pension funds have a responsibility to consider whether sustainability-related risks, including those that are considered system-level risks, will inhibit their ability to protect long-term value and provide an adequate pension to their members or beneficiaries.[1]

Our response to this consultation is focused on the topics of taking into account ESG considerations and understanding beneficiary preferences. The PRI's key recommendations are:

- **The VFM framework should include requirements for Independent Governance Committees (IGCs) to consider how firms take into account ESG considerations.** This would align the framework with existing regulatory requirements and recent legal clarifications on fiduciary duty, ensuring that sustainability factors are properly considered as part of evaluating long-term value creation for pension savers.
- The FCA should **analyse the potential unintended consequences of the VFM framework**. Due to the focus on investment performance, costs, and charges, there is a risk that concerns over short term performance alone could inhibit long term investment considerations such as climate goals and other sustainability concerns
- The FCA should also include guidance for schemes to **consider including sustainability-related questions in their customer satisfaction surveys**. This could provide an opportunity for beneficiaries to express their sustainability preferences, supporting them to engage with their pension, as well as helping pension schemes better understand their beneficiaries' interests.
- The FCA should recognise the value of investee and policymaker engagement and encourage investors to align their resources with their stewardship ambitions, fiduciary duty, beneficiary interests and client mandates. **The VFM should recognise stewardship's positive value and support greater resource allocation to enable it.**

[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

TAKING INTO ACCOUNT ESG CONSIDERATIONS

In the UK, extensive analysis of the legal framework shows that investors are generally permitted to consider sustainability impact goals where this would contribute to their financial objectives.[1] Our work shows that effectively managing ESG issues is a core part of the duties owed by trustees to their beneficiaries.[2] Reduced system-level risks could improve long-term financial outcomes, whereas neglecting ESG issues can lead to mispricing risk and poor investment decisions.

In February 2024, the Financial Markets Law Committee published [Pension Fund Trustees and Fiduciary Duties: Decision making in the context of Sustainability and the subject of climate change](), which examines the legal uncertainties surrounding the inclusion of sustainability and climate change when taking decisions as pension fund trustees. The paper provides a strong basis for trustees to address climate and other sustainability risks in their investments, emphasising that "sustainability is integral to decision making by pension fund trustees where it may affect financial return or risk."[3] The paper clarifies the interpretation of the law, underscoring that sustainability issues should first be considered as a financial factor by pension fund trustees and then assessed for materiality. It is also highlighted that "with climate-change related risks that are systemic, it is unlikely that diversification alone of a portfolio will be enough to avoid all the risks", and that "stewardship of an investment once made may be material to achieving (…) the balance of financial risk and return".[3]

Since 2019, pension fund trustees have been required to explain how they account for financially material ESG factors in their investment decisions as part of their annual Statement of Investment Principles (SIP). In 2020 an additional requirement was added to publish an Implementation Statement to support the scheme's policy claims within the SIP. However, the UK LFI report finds that the way UK investors understand and discharge their duties in practice may be discouraging them from pursuing positive sustainability impacts or even considering doing so. It is therefore important to ensure that sustainability considerations are integrated throughout pensions policy.

The PRI welcomes the recognition in the VFM framework consultation that "ESG factors may affect the long-term returns experienced by members." In response to question 30 of the consultation **we recommend that, the VFM framework should include stronger requirements for IGCs to consider how firms take into account ESG considerations.** This would align the framework with existing regulatory requirements and recent legal clarifications on fiduciary duty.

In addition, **the FCA should analyse the potential unintended consequences of the framework**. Currently the VFM framework is focused on investment performance, costs and charges, and quality of service. There is the risk that concerns over short term performance alone could inhibit long term investment considerations such as climate goals and other sustainability concerns.[4] Incorporating

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[2] PRI (2019) Fiduciary duty in the 21st century final report

[3] Financial Markets and Law Committee (FMLC) (2024), Paper-Pension-Fund-Trustees-and-Fiduciary-Duties-Decision-makingin-the-context-of-Sustainability-and-the-subject-of-Climate-Change-6-February-2024.pdf (fmlc.org)

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

ESG considerations more explicitly would create a more holistic framework that better captures the drivers of long-term value creation, which would help enable improved outcomes for pension savers while supporting a more sustainable financial system**.**

UNDERSTANDING BENEFICIARY PREFERENCES

Beneficiary interests have often been interpreted as solely being about seeking a certain financial return, yet it has become clear that many beneficiaries also have preferences related to the sustainability performance of their investments.[5] This is particularly relevant with the increase in DC provision, as the risks associated with investment decisions are borne by the member rather than the scheme sponsor.

The Legal Framework for Impact found that the levels of assets committed to sustainability impact investment approaches are lower than might be expected, based on expressed preferences of individual investors. It is also still not commonplace for pension funds to proactively incorporate the preferences of beneficiaries in their strategy or decision-making and there is often a lack of engagement from beneficiaries with their pension savings.[6] There are concerns about how and when to seek out beneficiary views, and whether this may lead to legal requirements to consider issues that may result in inadequate decisions.[7] The FCA should include guidance for schemes to **consider including sustainability-related questions in their customer satisfaction surveys**. The PRI guide Understanding and aligning with beneficiaries' sustainability preferences and Beneficiary Survey template could help inform the development of ESG-related questions and topics for inclusion in the customer satisfaction survey. This could provide an opportunity for beneficiaries to express their sustainability preferences, supporting them to engage with their pension, as well as helping pension schemes better understand their beneficiaries' interests.

RESOURCE ALLOCATION FOR STEWARDSHIP

The VFM framework should recognise the value of investor stewardship, **encouraging investors to align their stewardship resources with their stewardship ambitions**, consistent with their fiduciary duty, beneficiary interests and client mandates. A report by the Thinking Ahead Institute (TAI), commissioned by the PRI[8], provided insight into the level of stewardship resources within the industry, and promoted a structured measurement approach that can support better, more deliberate stewardship resourcing practices. The TAI concluded that better resourced stewardship is desirable and necessary to effectively manage systemic risks and maximise overall long-term value for clients and beneficiaries.

The VFM framework could also benefit from considering the Stewardship Resources Assessment Framework – an investment industry tool developed by TAI that organisations can use to self-assess their stewardship resourcing levels. We also recommend that FCA consider the work of the UN

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[5] PRI (2021) Understanding and aligning with beneficiaries' sustainability preferences

[6] FRC (2023) The UK Stewardship Code 2020

[7] PRI (2024) UK Pensions Policy

[8] TAI (2024) Putting resources where stewardship ambitions are

convened Net Zero Asset Owner Alliance, specifically its reports on the Future of Investor Engagement, Serving Asset Owner Clients through Climate Stewardship: A call to action to the asset management industry and Aligning Climate Policy Engagement with Net Zero Commitments: a foundation for asset owner engagement of asset managers. Along with the PRI's Stewardship for Sustainability Due Diligence Questionnaire, these documents provide guidance that asset owners could adopt to strengthen the quantity and quality of investor stewardship across asset classes and environmental, social and governance priorities.

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 FCA as the detailed rules and guidance for the VFM framework are developed.

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

More information on www.unpri.org