PRI RESPONSE

PENSION INVESTMENT REFORM: UNLOCKING THE UK PENSIONS MARKET FOR GROWTH

16 January 2025

To inform this briefing, the following investor group has been consulted: PRI Regional Policy Reference Group for the UK. This consultation is not an endorsement or acknowledgement of the views expressed in this briefing.

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 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, to seek views on proposed changes to unlock the UK pension market for growth.

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.

This second consultation sets out proposals to legislate for a minimum size and maximum number of Defined Contribution (DC) pension scheme default funds. These measures will enable the DC market to move to fewer, larger funds which are better placed to invest in productive assets and more able to deliver greater returns for members.

For more information, contact:

Kelly Krauter	Nikki King
Head, Financial Policy	Senior Policy Analyst, UK & Switzerland
kelly.krauter@unpri.org	nikki.king@unpri.org

KEY RECOMMENDATIONS

The PRI welcomes this second opportunity offered by the Pensions Investment Review to provide feedback on proposed legislative reforms for the Defined Contribution pension market. The PRI's targeted response will answer Questions 8 and 32 with recommendations aimed at supporting the UK government's net zero commitments and delivering better outcomes for pensioners.

The PRI's key recommendations are:

- Take a whole-of-government approach to economic transition, with well-defined roles and responsibilities for relevant regulatory authorities and government departments (including DWP and Treasury).
- Connect pension investment reform to broader enabling policies that support the investment of patient private capital in sectors driving the UK government's economic transition, providing clear, coherent and consistent policy signals to instil investor confidence and certainty.
- Act on recommendations by relevant regulatory authorities and parliamentary committees to bring the investment consultant service providers of pension trustees under the Financial Conduct Authority's (FCA) regulatory perimeter.

DETAILED RESPONSE

OTHER KEY RISKS FOR CONSIDERATION (QUESTION 8)

The PRI response to the call for evidence for the Pensions Investment Review encouraged fund consolidation where there are benefits to the market. It also recognised an opportunity to strengthen the case for policy reforms that could better serve the responsible investment of pension savings, and how efforts by the DWP and HM Treasury in this area would support the UK government's net zero commitments and align with the whole-of-economy transition.

- 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. 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.
- It is worth noting the broader policy environment that drives the economic transition and helps generate sustainable long-term value. As long-term investors, pension schemes are particularly susceptible to sustainability risks such as climate change and are also well-positioned to direct funds into green long-term productive assets like infrastructure and housing stock.

Treasury and DWP should work in concert with other UK government departments and relevant regulatory authorities to provide clear, coherent and consistent policy signals that instil investor confidence and certainty to invest in sectors driving the UK's economic transition. The PRI has welcomed the government's consultation on the UK's Modern Industrial Strategy as a key step to driving the wider Growth Mission and embedding a long-term, clear and stable direction of travel into policymaking. We notably recommend to:

- Take a whole-of-government approach to the transition, backed by sectoral roadmaps with clear pathways to decarbonisation and an investment strategy with time-bound commitments and incentives to crowd-in private finance;
- Create an enabling policy environment by implementing wider sustainable finance policies and standards, such as mandatory transition plan disclosure requirements and a robust, evidence-based sustainable taxonomy, in a coordinated manner with clear timelines for delivery.

A stable and coherent policy environment for pension investment decision making would connect pension investment reform to broader enabling policies in support of the economic transition, with clarified roles and responsibilities of different government departments (including DWP and Treasury) in transition efforts. This would help pension funds and other institutional investors to play an important part in financing green growth, supporting the UK Government's key priorities, facilitating the energy transition, and achieving net zero targets.

INCREASED REGULATORY OVERSIGHT OF INVESTMENT CONSULTANT SERVICES IN SUPPORT OF BETTER PENSION OUTCOMES

The PRI is currently updating its sustainable finance policy toolkit, building on our regulation database and extensive engagement with signatories, academics and policy makers. Our research has found that challenges occur when the principal (e.g., shareholders or asset owners) and intermediaries in the investment value chain (e.g., service providers, investment consultants, company directors or investment managers) have different interests. The agent usually has more information which it may use to pursue self-interest at the cost of the interests of the principal.

Given the growth of service providers and asset managers over the last decade, these agents may now be larger in scale, representing a diverse set of principal views that do not easily converge on sustainable investment decision-making. In the context of addressing system-level sustainability-related risks, agency challenges are also evident when shareholders or asset owners with diversified portfolios seek long-term sustainable returns and system-level stability, while company managers prioritise maximising company benefits, potentially at the expense of broader system stability.

The exposure draft of the updated sustainable finance toolkit, which the PRI can share in case of interest, recommends that regulators adopt service providers sustainability regulations. Service providers, as defined by the toolkit, are a diverse group of market participants that offer specialised services and expertise to help businesses, investors and other stakeholders integrate sustainability factors into their operations, decision-making processes and reporting. This group includes index providers, ESG research, rating and data providers, credit rating agencies, auditors and certifiers, investment consultants, and proxy advisors.

Where possible, sustainability regulations for service providers should aim to integrate sustainability factors into any existing regulations, to ensure service providers can serve the best interests of their clients in relation to sustainability-related risks and opportunities. They typically expect service providers to enhance transparency regarding policies, practices and methodologies, manage conflicts of interest, integrate sustainability-related factors into services and business operations, and assess the sustainability impacts of their services.

Service provider sustainability regulations will enhance transparency, accountability, integrity, governance and professionalism: they will ensure that service providers are equipped to help clients meet their sustainability commitments effectively. Regulating this segment of the investment chain would better enable clients to hold service providers to account by setting clear sustainability-related operational and business standards.

In the UK, the FCA[1], the CMA[2], parliamentary committees[3] and other interested parties[4] have all called for investment consultants to be brought within the FCA's regulatory perimeter. The fiduciary management arms of investment consultants fall within the FCA's scope, but consultants' investment advice to pension trustees is generally not regulated. The PRI encourages Treasury to act on these recommendations to regulate investment consultant services to pension trustees.

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 Treasury further to develop pension policy.

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

---

[1] FCA Perimeter Report (2022) Our perimeter report | FCA

[2] CMA "Investment Consultants Market Investigation (2018) Final report

[3] House of Commons Work and Pensions Committee Report (2022) https://committees.parliament.uk/publications/40563/documents/197799/default/

[4] ShareAction (2024) ShareAction | HM Treasury should expedite the regulation of…

More information on www.unpri.org