POLICY BRIEFING

UK PENSIONS POLICY

March 2024

ABOUT THE PRI

The Principles for Responsible Investment (PRI) is the world's leading initiative on responsible investment. The PRI has now over 5,000 signatories (pension funds, insurers, investment managers and service providers) to the PRI's six principles, representing US $121 trillion in assets under management.

The PRI supports its international network of signatories in implementing the Principles. As long-term investors acting in the best interests of their beneficiaries and clients, our signatories work to understand the contribution that environmental, social and governance (ESG) factors make to investment performance, the role that investment plays in broader financial markets and the impact that those investments have on the environment and society as a whole.

The PRI works to achieve this sustainable global financial system by encouraging adoption of the Principles and collaboration on their implementation; by fostering good governance, integrity, and accountability; and by addressing obstacles to a sustainable financial system that lie within market practices, structures, and regulation.

ABOUT THIS BRIEFING

The UK pensions sector manages over £2 trillion of assets[1] and worldwide the pensions sector has approximately £38 trillion assets under management.[2] Pension funds, as universal asset owners, can play a key role in influencing how systemic sustainability issues, such as climate change, are addressed by other actors, and drive long-term value creation by pursing positive sustainability outcomes that mitigate the root causes of these risks. 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.

The PRI's 2020 report on the UK pensions market identified a number of policy and structural barriers to creating a sustainable pensions system. In recent announcements such as the Mansion House Speech (July 2023), the Autumn Statement (November 2023) and the Spring budget, the UK government has shown a renewed interest into pensions investment practices, market structure, and policies that influence the performance of pension schemes. These proposals aim to shift incentives away from a focus on cost towards long-term value and investment performance, without including specific considerations linked to sustainability outcomes or the economic and social benefits of the transition to net zero.

This brief builds on existing PRI pensions and fiduciary duty work, analysing some of the key UK policy developments since 2019, highlighting areas that require further work and the PRI's recommendations to help address ongoing issues.

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[1] Pensions and Lifetime Savings Association (2023), Pensions and Growth,
[2] Thinking Ahead Institute (2023) Global Pension Assets Study - 2023

KEY RECOMMENDATIONS

Pension funds are required to secure long-term financial interests and therefore have a responsibility to consider whether system-level sustainability risks[3] are relevant to their ability to meet their legal obligations and objectives and, if so, how they can mitigate these threats.[4] This can be achieved by pursuing positive sustainability outcomes[5], which require long-term financing, capital allocation and stewardship activity.

The below recommendations detail key elements necessary to build and implement a long-term, sustainable pensions policy environment in the UK.

- **Mainstreaming the integration of sustainability impacts in investment decisions**: while sustainability is now widely accepted as a key issue for investors, it is still not fully embedded into established practices. Policymakers should support improved practices by providing **training to understand ESG issues** and **guidance on how to assess sustainability risks and how to set and pursue sustainability impact goals**.
- **Improving the efficiency and integration of sustainability issues throughout the investment ecosystem**: investment managers, consultants, and service providers often play an important role in the decision-making process of trustees, it is therefore important that they are given clear expectations to ensure proper consideration of sustainability risks in their work. We recommend that policy makers **provide trustees with a standard investment management agreement**, outlining terms that permit pursuing sustainability outcomes and encourage stewardship, as well as **guidance on how to assess these activities.**
- **Increasing the effectiveness and scalability of stewardship:** stewardship is an essential tool for investors to pursue sustainability impact goals, to ensure that activities are translating into concrete outcomes investors should prioritise systemic issues and activities with clear, achievable goals. Policymakers should encourage **actions to pursue positive sustainability impacts that go beyond asset allocation, highlighting the importance of collaborative action.**
- **Integrating beneficiary preference in investment decision**: while there is increasing acknowledgement that beneficiary preferences should be reflected in investment decisions, it is still not common due to concerns about methods for gathering views, and the potential legal obligations to consider issues that may result in inadequate decisions. We recommend that policymakers develop **guidance on how schemes can engage with their beneficiaries** and how to put these preferences into practice, including on issues such as sustainability value drivers, risks, and outcomes.

[3] System-level risks is a catch-all term for systematic risk and systemic risk, both of which have implications for investment performance.
[4] Freshfields Bruckhaus Deringer, PRI, United Nations Environment Programme Finance Initiative, Generation Foundation (2021), [A Legal Framework for Impact: Sustainability impact in investor decision-making]
[5] Sustainability outcomes are the positive and negative effects of investment activities on people and/or the planet. They are understood in the context of global sustainability goals and thresholds.

ANALYSIS

ENSURING AN OUTCOMES-ORIENTED REGULATORY FRAMEWORK

UK regulations to date have mainly focus on transparency, however a stronger emphasis on ESG (e.g. regarding its place in the duties of pensions funds) and support to embed sustainable investment practices into business-as-usual activities is needed.

TRANSPARENCY

A standardized approach for trustees to work with their investment managers is needed to ensure that clear expectations are set, and investment managers are transparent about available products and their stewardship activities. We recommend that policymakers complement existing transparency requirements including through the development of standardised templates for Investment Management Agreements (IMA), which trustees can adapt to their specific needs.

State of Play

Disclosure requirements are the main regulatory tool to substantiate sustainability claims whilst also improving how markets function by increasing the accountability of sustainable products and entities. Well-designed disclosure standards can also influence behaviour by investors and reduce the risk of greenwashing.

Since 2019, pension fund trustees have been required to explain how ESG factors, where financially material, are taken into account in investment decisions in 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.

In 2021 the UK became the first jurisdiction to mandate the largest pension schemes to report in line with the requirements of the Taskforce on Climate-related Financial Disclosures (TCFD), through the Climate Change Governance and Reporting Regulations, and to require schemes to select and report on metrics that indicate their progress towards alignment with the Paris Agreement. An interim review will be conducted to identify best practice and whether to extend the mandate to smaller schemes.[6]

The FCA's Sustainability Disclosure Requirements (SDR) and investment labels policy statement was published in November 2023. The regime aims to **bring regulatory clarity on greenwashing as well as increase transparency and trust in sustainable investing**.[7] Although the regime does not currently apply to pensions, there will be consideration in the medium term to extend the regime to pension products. Any such extension should consider whether regulation by DWP or TPR is more appropriate to avoid potentially duplicative regulations and excessive or unnecessary costs of compliance with multiple regulators.

Further areas of work

The absence of a standardised approach for trustees to work with investment managers creates transparency and accountability issues, making it more difficult to allocate capital efficiently, account for sustainability-related financial risks and opportunities, and address sustainability goals.[8]

[6] UK Government (2021) Taking action on climate risk: improving governance and reporting by occupational pension schemes
[7] FCA (2023) Sustainability Disclosure Requirements and investment labels
[8] For example, FTSE Russell found that of the 4,000 large and mid-size constituents in the FTSE All World index, only 58% disclose both Scope 1 and 2 carbon emissions. Source – LSEG (2022) Mind the gaps: Clarifying corporate carbon

Trustees should be encouraged to set clear expectations and requirements for investment managers, to ensure that the latter appropriately consider sustainability-related system level risks and beneficiary preferences when making investment decisions or carry out stewardship activities to achieve sustainability outcomes. We recommend that DWP, in consultation with the industry, develop an **IMA template.** [9]This should include a **standard set of terms that permit investment managers to pursue desired sustainability outcomes** and **require them to do so where necessary to mitigate system-level risks.**[9]

Investment managers should also be transparent about the products available to pension schemes and provide information not only on how capital is allocated, but also the stewardship practices that would be undertaken with each option. The template agreement should **acknowledge the importance of and encourage investment managers to use stewardship and policy engagement to pursue desired sustainability outcomes.** Lastly, the agreement should require investment managers to **disclose how they are financially resourcing these activities**.[9]

Other outstanding issues around transparency which would require further analysis include:

- reporting that is fit-for-purpose as much of the new reporting is focused on governance and risk management, rather than the sustainability impact of portfolios;
- the accessibility of data, particularly on outcomes; and,
- issues with the validity of economic studies and investment models used in decision-making by trustees.[10]

TRUSTEE REQUIREMENTS

The UK regulatory framework's emphasis on climate change needs to be expanded to systematically incorporate other sustainability issues, including with regards to the fairness of the economic transition. As the government continues to develop pension reforms, it is important to ensure alignment with the government's net zero commitments and the whole of economy transition.

State of play

There have been some notable developments by policymakers and regulators on addressing sustainability risks in the UK, with a particular focus on climate change. In addition to the regulations mentioned in the section on transparency, these include:

- the publication of statutory and non-statutory guidance in 2022, requiring more detail on stewardship activities, with a focus on voting and engagement: the guidance set new expectations for trustees to be more proactive in their stewardship activities, providing climate change, biodiversity, and modern slavery as examples for suitable stewardship priorities. The government committed to review the guidance in the second half of 2023; and [11]
- the creation of the Taskforce on Social Factors launched in 2023 by the Department of Work and Pensions (DWP):[12] the Taskforce published its Considering Social Factors in Pension Scheme Investments report in March 2024 to support trustees with managing social factors, providing

[9] PRI (2023) Response to DWP/HMT call for evidence – Pensions trustee skills, capability and culture
[10] Carbon Tracker (2023) Loading the DICE Against Pensions
[11] UK Government (2022) Reporting on Stewardship and Other Topics through the Statement of Investment Principles and the Implementation Statement: Statutory and Non-Statutory Guidance
[12] UK Taskforce on Social Factors (2023) Launch of Taskforce on Social Factors for UK Pensions Industry

trustees with the tools to identify and monitor social risks and opportunities.[13] The taskforce also published recommendations for the pensions industry, regulators, and governments to improve the integration of social factors in pension scheme investment.

Further areas of work

Despite these developments, the UK regulatory framework remains incomplete in terms of consideration of wider sustainability risks such as sustainability outcomes or nature-related risks. The recent focus on pension reform in the Mansion House speech, the Autumn Statement and the Spring budget do not refer to the importance of considering sustainability risks. **Upcoming policy reforms should take into consideration and address the government's net zero commitments** and ensure alignment with the whole of economy transition, ensuring that the stakeholders affected by the transition are empowered to participate in the process and investment is directed to ensure that workers and communities can develop the capabilities needed, with a particular focus on the spatial and place-based dimensions of the transition.[14]

FIDUCIARY DUTIES

Sustainability issues are long-term value drivers which require pension schemes to consider and potentially mitigate as part of fiduciary duties. However, this has not been adopted into business-as-usual practices. To address this, policymakers should clearly signal that these requirements are included within fiduciary duties, and provide guidance on how to identify, assess and address sustainability impacts.

State of Play

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.[4] Our work shows that effectively managing ESG issues is a core part of the duties owed by trustees to their beneficiaries.[15] Reduced system-level risks could improve long-term financial outcomes, whereas neglecting ESG issues can lead to mispricing risk and poor investment decisions. In the absence of more explicit guidance and direction, asset owners and asset managers may remain hesitant to change their established practices and pursue sustainability impact goals, even when this is required to achieve financial objectives.[16]

In March 2023 the UK Government published Mobilising Green Investment, Green Finance Strategy 2023 (2023 GFS), an update to the 2019 Green Finance Strategy and the 2021 Greening Finance Roadmap. The strategy highlights that "*in DWP's Stewardship Guidance, introduced in 2022, the UK government stated that trustees may want to consider both financial and non-financial matters in their stewardship activities*", and indicates that DWP "*will examine the extent their Stewardship Guidance is being followed in late 2023*." It further commits the UK Government to "*engage with interested stakeholders on how we can continue to clarify fiduciary duty through a series of roundtables and a working group of the Financial Markets and Law Committee (FMLC)*."[17]

In February 2024, the FMLC 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 begin to address climate and

[13] UK Taskforce on Social Factors (2024) Considering Social Factors in Pension Scheme Investments
[14] PRI (2023) Investing for the economic transition: The case foe whole-of-government policy reform
[15] PRI (2019) Fiduciary duty in the 21st century final report
[16] PRI (2022) A Legal Framework for Impact UK: Integrating sustainability goals across the investment industry,
[17] UK Government (2023) Mobilising Green Investment – 2023 Green Finance Strategy

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*."[18] 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*".[18]

The FMLC review is primarily intended for pension fund trustees, but as emphasised in the paper, it is also of relevance for advisers and investment or fund managers, beneficiaries and employers, insurers, and investees. It addresses climate change specifically, but stresses that the approach remains relevant to other areas of sustainability. **Further work is needed to mainstream these findings and develop additional guidance on how to address sustainability risks and impacts**.

The Mansion House Reforms included proposals to boost returns and improve outcomes for pension fund holders whilst increasing liquidity for high-growth companies. The speech stressed the need to improve trustee understanding of fiduciary duty and changing the "the culture of investment decisions".

The Spring Budget reiterated the importance of improving outcomes for pension savers, comparing UK's pension funds' performance with other markets that are seen to generate better returns with different investment strategies. The Chancellor introduced **new requirements for funds to disclose their level of international and UK equity.**[19] The proposal includes a requirement for schemes to compare their performance, with penalties expected where consistently poor outcomes are reported, including closing a scheme to new employer entrants or winding up a scheme.[19] This could create a more risk-averse sentiment within the pensions industry, placing undue pressure on trustees and preventing them from fulfilling their fiduciary duties.[20]

In July 2023 DWP and HMT published a call for evidence on Pension trustee skills, capability and culture, seeking information on whether guidance on fiduciary duty is sufficient to help trustees make decisions in the best long-term interest of savers (see the PRI's response here). The government's response to the consultation found that the majority of respondents considered that fiduciary duties are a well-established and well-understood concept, but there can be "*some inconsistency in interpretation*". The call for evidence also highlighted that there is lack of clarity around how fiduciary duty interacts with sustainability and climate change considerations. However, there was **no mention of the need to consider systemic risks or sustainability outcomes** to ensure long-term investment returns for beneficiaries in the government's proposals.

Further areas of work

By updating standards and guidance, policymakers can provide clarity on when investors' legal duties enable or require them to consider pursuing sustainability impact goals.[16]

The FMLC paper helps to clarify uncertainties around fiduciary duty, which in turn can help to shift trustees' practices in line with sustainability risks and objectives. To facilitate this, DWP guidance and TPR codes of practice should integrate the findings of the FMLC paper and make clear **that the requirement to consider ESG risks encompasses an obligation to consider taking active steps to pursue sustainability impact goals** when this would help achieve financial risk/return objectives. Guidance is required not just to understand fiduciary duties but also their application: this should address **how pensions funds can assess sustainability risks and impacts and how to set and**

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[18] Financial Markets and Law Committee (FMLC) (2024), Paper-Pension-Fund-Trustees-and-Fiduciary-Duties-Decision-making-in-the-context-of-Sustainability-and-the-subject-of-Climate-Change-6-February-2024.pdf (fmlc.org)
[19] UK Government (2024) Spring Budget 2024
[20] Kokosvaka (2024) DC schemes to disclose domestic assets as government seeks to boost UK business

pursue sustainability impact goals. In addition, the UK government should encourage and support efforts by the investment industry and other stakeholders to **develop and endorse examples of good practice or case studies**.[16]

Consultants and asset managers service a large share of pension assets and can be influential in determining the degree to which ESG issues are embedded in pensions scheme investment strategies. The PRI's research on the UK pension system found that **appropriate incentive structures are needed for asset managers, investment consultants and other service providers** to pursue ESG investment, stewardship, and responsible investment goals.[4] In some cases, while service providers are well placed to execute responsible investment and stewardship goals, the lack of incentives in practice can limit execution.

Investment consultants are instrumental in determining the degree of sustainability embedded in the investment strategies of the pension plans they advise.[21] The Competition and Markets Authority (CMA) found that **consultants do not usually include investment strategies in their watch lists until they have a three-year track record**, and there are still a relatively small number of sustainable investment funds that meet this threshold.[22] It can therefore be difficult for innovative funds that address sustainability issues to raise capital. This could prevent trustees from considering the full breadth of investment opportunities when making investment decisions. To address this, guidance should not only be directed at trustees but also apply to service providers.

STEWARDSHIP

Stewardship is still often seen as suitable for only some purposes rather than as an integral part of investors activities. UK regulators should continue to encourage outcome-oriented stewardship, including collaborative engagement, as well as providing guidance that enables trustees to better assess their investment managers on their stewardship practices.

State of play

Stewardship is an essential tool for investors pursuing sustainability impact goals to address system-level risks which cannot be mitigated by simply diversifying portfolio holdings. The FMLC paper recognised that stewardship "*may be material to achieving or maintaining (or improving) the balance of financial risk and return).* The UK Stewardship Code underwent a major review and consultation process in 2019 to strengthen it. Since the revision **there has been evidence of material changes of practice** with increases in the resourcing of stewardship and better integration of stewardship in investment decision-making through organisational restructuring.[23]

The 2023 GFS committed the Financial Reporting Council (FRC) alongside the Financial Conduct Authority (FCA), DWP and TPR to review the regulatory framework for effective stewardship, including the Stewardship Code.[17] The review of the code will focus on the extent to which the code supports long-term value creation, has created reporting burdens, and whether there has been any unintended consequences such as short-termism in targets. The review will be undertaken in phases starting with targeted outreach to the four main groups affected by the Code, a public consultation, and the revised code will likely be published in early 2025.[24]

In October 2023 the CMA launched its Green Agreements Guidance on the application of the Competition Act 1998, to "*ensure that competition law does not impede legitimate collaboration*

[21] Fabian et al (2023) Private Retirement Systems and Sustainability: Insights from Australia, the UK, and the US
[22] PRI (2020) Private Retirement Systems Australia, the United Kingdom, and the United States
[23] FRC (2022) The influence of the UK Stewardship Code 2020 on practice and reporting
[24] https://www.frc.org.uk/news-and-events/news/2024/02/statement-frc-policy-update-launch-of-the-uk-stewardship-code-2020-review/#:~:text=As%20stated%20in%20the%20FRC's,growth%20and%20the%20UK's%20competitiveness.

between businesses that is necessary for the promotion or protection of environmental sustainability". The guidance explains how competition law applies to environmental sustainability agreements between firms,[25] and **confirms that agreements between shareholders to vote in support of corporate policies that pursue green goals are unlikely to infringe competition law**. Pension schemes are active in a number of collaborative initiatives such as Climate Action 100+, the Investor Policy Dialogue on Deforestation and Advance and this should continue to be encouraged in guidance on stewardship.

TPR has published a new General code of practice which is expected to come into force at the end of March 2024. The code brings together and updates 10 existing codes of practice into one set of expectations on scheme governance and administration.[26] The new code highlights that "*Stewardship provides an effective tool for encouraging, developing, and supporting behaviours and practices … to ensure long-term value for savers, which can also lead to sustainable benefits for the economy, the environment and society."*[27]

Further areas of work

The UK has established a high standard for stewardship practices, which should be used as a baseline for future regulatory developments to drive improvements in investor stewardship practices and the delivery of positive sustainability impacts. We encourage the FRC to **maintain the high level of integrity and ambition** that have made the UK a front-runner on stewardship practices, and update guidance to encourage the use of stewardship to tackle the drivers of system-level sustainability risks.

UK regulators should **clarify that the actions available to investors to pursue positive sustainability impacts go beyond decisions to acquire or dispose of certain assets to all activities** by or on behalf of investors in relation to their investments. In particular, regulators should encourage stewardship, including collaborative engagement, by or on behalf of pension funds to improve investees' sustainability impacts. **It should be clear that in many cases, active steps may best be taken collectively with other investors and third parties**.[16]

PRI data shows that while asset owners are increasingly making sure their managers' stewardship policies align with their own policies or expectations, more granular assessments of asset managers' approaches are less common – including assessments of the extent to which they prioritise systemic sustainability issues. TPR should develop guidance for trustees **on assessing the quality of investment managers' stewardship, appropriate resourcing levels for stewardship activities, and expectations for trustee monitoring of manger stewardship.** Trustees should also be encouraged to **set effective targets for stewardship activities** which have a focus on outcomes and escalation strategies if those goals are not achieved**.** [28] The PRI recently released guidance on evaluating managers' stewardship for sustainability which could help inform TPR guidance.

TIME HORIZONS

Addressing climate change and ensuring an orderly transition are in the long-term interest of beneficiaries, however short-term considerations continue to impair pension funds' abilities to fully take into account longer time horizons. UK Policymakers should encourage a shift in

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[25] CMA (2023) Green Agreements Guidance: Guidance on the application of the Chapter 1 prohibition in the Competition Act 1998 to environmental sustainability agreements
[26] TPR (2024) Pension trustees challenged on TPR's general code
[27] TPR (2024) General code of practice
[28] In PRI's consultation response to the FCA Sustainability Disclosure Requirements and Investment Labels (in particular Question 6), we set out in more detail elements to consider for credible stewardship strategies, in particular what the concepts of contribution and additionality mean in relation to the assessment of impact.

timeframe considerations through clarification of duties and supporting the use of qualitative information as well as quantitative.

State of play

Regulators have identified that UK pension assets do not fully reflect long-term sustainability risks.[29] Pension schemes should therefore consider their investment funding time horizons, and the sustainability impacts and risks that may arise at various times up to the likely end of their lifecycle. Reduced system-level risks could improve long-term financial outcomes, whereas neglecting ESG issues could lead to mispricing risk and poor investment decisions. In turn this could undermine their short, medium, and long-term investment returns for beneficiaries. Currently there are concerns that both Defined Benefit (DB)[30] and Defined Contribution (DC) schemes[31] have operational challenges that incentivise shorter investment horizons for portfolios compared to the long-term nature of pensions schemes.[16]

The UK government published the draft The Value for Money: A framework on metrics, standards, and disclosures in July 2023, which aims to encourage a cultural shift across the DC pensions market from focusing on costs to overall value and accelerate market consolidation. When speaking about the framework in the Mansion House Speech the Chancellor explained that "*investment decisions should be made on the basis of long-term returns and not simply cost*." However, the framework does not include sustainability as one of the desirable "member outcomes" and may increase pressure on short-term performance, which could discourage sustainable investing.

The Mansion House Reforms include the Mansion House Compact, an agreement between nine of the UK's largest DC pension providers to commit to the objective of allocating 5% of assets in their default funds to unlisted equities by 2030.[32] This could help incentivise other DC schemes to hold longer-term less liquid assets. Non-liquid assets can include infrastructure such as renewable energy projects as well as roads and hospitals.[33]

The pension reforms announced as part of the government's Autumn Statement 2023 included a commitment to engage further with industry on proposals on how to shift employer incentives away from low fees towards long-term pension investment performance.

Further areas of work

The recent FMLC paper set out that "*it may be necessary to consider whether short term gains should be rejected if they create risks to the longer-term sustainability of investment returns*.",[18] and suggests looking at applicable or relevant time horizons to ensure effective decision-making.

To ensure that trustees are considering the relevant time horizons for sustainability risks and impacts, building on the conclusions of the FMLC paper, policymakers should clarify that **pension schemes should take into account not only long-term sustainability impacts but also short- and medium-term sustainability impacts**, since these may affect financial risk and returns over a range of timescales. Investors often rely on quantitative modelling, and while this can be a valuable tool for assessing risks, uncertain forecasts and data limitations become particularly evident when evaluating long-term sustainability risks. **To gain a more comprehensive understanding, pensions schemes should also consider qualitative information.**[18]

[29] UK Government (2019) Green Finance Strategy
[30] DB schemes are required to prepare a valuation every three years which often results in a reset of investment strategies. Although this does not prevent schemes from having a long-term approach higher funding levels – from higher discount rates - have led to shorter time horizons as DB schemes prepare for buyout by an insurance company.
[31] DC schemes have historically aimed to offer daily liquidity, to keep costs low. See – Phoenix Group (2023) Facilitating access to illiquids for DC schemes and Master Trusts
[32] UK Government (2023) Chancellor's Mansion House Reforms to boost typical pension by over £1,000 a year
[33] UK Government (2016) Investment News – Monthly Bulletin from the Insurance & Investment Team

SUSTAINABILITY-ALIGNED INVESTMENT PRACTICES

Providing trustees and service providers with relevant sustainability training and increasing diversity on trustee boards will enable investment practices to keep pace with evolving regulations. Diverse trustee boards will also strengthen beneficiary representation, whilst engaging with beneficiaries further facilitates informed investment decisions that consider their long-term interests.

BENEFICIARY ENGAGEMENT

Engaging with beneficiaries and incorporating their preferences into pensions scheme's strategy or decision-making is still not commonplace. To assist trustees with changing their practices policymakers should develop guidance on how schemes can engage with their beneficiaries and how to incorporate their preferences.

State of play

The UK's Occupational Pension Schemes (Investment and Disclosure) regulations currently require "*trustees of trust-based occupational pension schemes to specify the extent (if at all) to which they consider the views of members and beneficiaries on non-financial matters, including sustainability, when it comes to the selection, retention and realisation of investments*".[34] A similar expectation is in place for the Independent Governance Committees of contract-based pension schemes.[35] TPR expects trustees of DC plans to take regular steps to "*consider any information provided when determining investment options to offer to members and strategies for the scheme including preferences for particular approaches to investment (e.g. sustainable funds)*".[36] The UK Stewardship Code also encourages signatories to consider beneficiaries' interests and preferences. [34]

Further areas of work

Beneficiary interests have often been interpreted as solely being about seeking a certain financial return, yet it has become clear that many beneficiaries have preferences related to the sustainability performance of their investments.[34] 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.

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.[37] 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. **For this reason, incorporation of beneficiary preferences in decision-making should not be made mandatory.**

We recommend that DWP develop non-mandatory guidance **on how schemes can engage with their beneficiaries to better understand and incorporate member preferences into investment decisions**. The guidance should cover the benefits of incorporating beneficiary preferences, the challenges of engagement and potential solutions, the different methods that can be used and how to design them, as well as how to put the preferences into practice. The PRI guide Understanding and aligning with beneficiaries' sustainability preferences and Beneficiary Survey template may help inform DWP's guidance.

[34] PRI (2021) Understanding and aligning with beneficiaries' sustainability preferences
[35] FCA (2020) PS19/30 Independent Governance Committees: extension of remit
[36] TPR DC code of practice | The Pensions Regulator
[37] FRC (2023) The UK Stewardship Code 2020

TRAINING AND DIVERSITY

Providing trustees and service providers training on ESG issues as well as encouraging more diversity on trustee boards will help pension funds to make better educated investment decisions, therefore taking advantage of the full breadth of investment opportunities.

State of play

New trustees are required to undertake training within the first 6 months to ensure that they have the relevant skills, knowledge and understanding on pensions and trusts, and TPR strongly recommend that this is reviewed at least annually.[38] In its February 2023 discussion paper, Finance for positive sustainable change: governance, incentives and competence in regulated firms, the FCA noted '*the importance of training and competence and the need for genuine capability building across the financial sector*".

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 however a **general acknowledgment that trustees would benefit from more guidance and training**.[39] The new General Code of Practice under the section on Knowledge and Understanding states trustees should be aware of any policies adopted on stewardship, ESG, and climate change.[27]

The call for evidence response also supports findings that having a diverse range of trustees can help to improve scheme outcomes.[32] In March 2023 TPR published Equity, diversity and inclusion (EDI): detailed guidance, providing practical ways to improve EDI and highlighting that "*EDI supports robust discussion and effective decision making and is an important consideration for schemes.*"[40] Additionally, TPR launched a survey in July 2023 to obtain a clearer picture of trustee diversity, designed to help TPR understand what diversity and inclusion data is being collected by schemes and measure awareness of TPR's equality, diversity and inclusion action plan.[41]

Further areas of work

ESG-related training should be provided to pension fund trustees, as well as other key service providers.[9] This would ensure they are equipped to take sustainability factors into account in their decision-making and allow them to consider pursuing positive sustainability impacts where relevant to achieving the purpose and objectives of the scheme.[16]

Building on the existing requirement for trustees to undertake relevant training within their first six months, policymakers should consider establishing **legal requirements to demonstrate minimum trustee knowledge and understanding regarding ESG** and other key areas. This would provide trustee boards with the ability to ensure that policies are effective, and to challenge asset managers and service providers on their integration of ESG issues.

Finally, **the government should look at how to encourage more diversity on trustee boards,** as this is likely to improve the breadth of knowledge available to the board to consider different investment opportunities. An example can be taken from the Australian Council of Superannuation investors which has a recommended target of women occupying at least 40% of board positions for listed companies.[41] Trustee boards that lack diversity risk knowledge gaps, entrenched ideas, biased thinking, and poor decision making.[42]

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[38] TPR, What new pensions scheme trustees need to know
[39] UK Government (2023) Call for evidence outcome Pension Trustee skills, capability and culture
TPR (2023) Governing bodies: EDI guidance
[41] TPR (2023) First trustee diversity and inclusion survey launched by TPR
[42] Linklaters (2022) Diversity on trustee boards