INFLUENCE WORKSTREAM: IDEAS TO HELP PENSION SCHEME TRUSTEES FOCUS ON MORE IMPACTFUL INVESTMENT DECISIONS

Position paper, 10 February 2025

The Investment Consultants Sustainability Working Group (ICSWG) exists to "drive better sustainable investment practices across the investment industry". Formed in 2020, the ICSWG is a collaboration between 19 UK investment consultancy firms.

ICSWG's Influence workstream was set up in early 2024 to work with regulators and policymakers. Our goal is to free pension scheme trustees from 'tick box' exercises, so they can focus on more impactful decisions that boost sustainable investment and enhance scheme members' outcomes.

We're keen to implement our ideas with regulators and policymakers, driving better sustainable investment practices by UK pension schemes. We'll do this through our interactions with the Department for Work and Pensions (DWP), the Pensions Regulator (TPR) and the Financial Conduct Authority (FCA), with further relationships developed as appropriate.

Areas of focus

The problem we perceive
Much of the UK's pension fund sustainability regulation and policy has used enhanced reporting requirements, with the intention that these will lead to behavioural changes over time. However, a consequence of this model is that trustees' time and expense budgets are absorbed by what tend to be seen as regulatory reporting 'tick box' exercises, rather than directly improving outcomes for scheme members. The fragmented nature of the UK asset owner market, with its many small schemes, exacerbates this problem with heightened compliance costs and less coordinated practical action across schemes to support sustainability.

There are also concerns about 'paper portfolio compliance', such as decarbonising a portfolio by selling high-carbon assets, rather than driving real-economy changes in the behaviour of investors or the underlying companies that seek to protect the value of members' benefits.

Our objective
The initial objective of the ICSWG Influence workstream is: "To help and enable pension scheme trustees to focus more on impactful investment decisions and less on reporting and regulatory compliance".

The workstream's definition of 'more impactful decisions' is to take a double materiality approach: decisions that enhance the financial risk/reward of investments and drive real-world change towards a more sustainable economy, from social and environmental perspectives. As the recent Financial Markets Law Committee (FMLC) paper makes clear, such a focus on real-world outcomes to the benefit of members is wholly within trustees' fiduciary duties.

Areas of focus
The workstream has three initial areas of 'influence focus':

1. Working with regulators to simplify, reduce and harmonise reporting requirements and regulatory burdens, enabling trustees to spend more time on impactful actions.

2. Working with regulators, policymakers and others to remove barriers and encourage sustainable investing, with a double materiality objective. This includes investing across public and private markets as well as the full range of sustainable investing approaches recognised under the FCA's Sustainability Disclosure Requirements regulation.

3. In line with the UK government's focus on encouraging investment in the UK economy, work with regulators to amend or propose regulation that reduces barriers and incentivises allocations to opportunities that drive a more sustainable economy, including private market impact strategies. This could include amending regulations to encourage investment (e.g. increase Long-Term Asset Fund (LTAF) take-up) or propose new ideas (e.g. facilitate *in specie* transfer of assets from DB schemes to insurers in buy-in transactions).

Further detail on the three focus areas is detailed below.

Focus Area 1 – Simplification of UK pension scheme sustainability reporting

Introduction – the current state of sustainability reporting
While we support public sustainability reporting by pension schemes, we note that regulatory scrutiny can increase the time to prepare these reports. Moreover, trustees may be cautious about what they report, particularly forward-looking statements, because of concerns about inadvertent greenwashing or challenge if sustainability becomes more politicised.

We also note that current sustainability reporting can be difficult for members to digest. Some schemes have opted to produce additional member-friendly communications, another demand on bandwidth.

To inform reporting policy, we suggest that the DWP or TPR survey a representative sample of pension schemes to understand:

- the approximate cost per scheme of all sustainability-related reporting, including data collection, report drafting and editing, adviser review and compliance checks.
- the proportion of trustee time, in-house executive time and adviser fees spent on sustainability-related reporting compared to other sustainability-related activities.

Our vision for the future: a unified sustainability reporting framework
We propose that sustainability reporting for occupational pension schemes takes the form of:

- **A single sustainability policy** setting out relevant governance arrangements, investment beliefs and risk management processes. This would be subject to review at least every three years.
- For larger schemes, **an annual report** describing the implementation of sustainability policy. For other schemes, **a triennial sustainability report** describing policy implementation.

This would **replace all the current mandatory and voluntary sustainability reporting requirements**, including implementation statements, Stewardship Code reports, Taskforce on Climate-related Financial Disclosures (TCFD) reporting etc.

Certain elements would be mandatory, initially corresponding to current requirements (implementation statements and TCFD reports for schemes meeting certain criteria). The rest would be optional.

Where data is sourced from third parties (e.g. climate-related metrics, voting statistics and managers' engagement activities), trustees are strongly encouraged to report data for the 31 December falling within the reporting period (either as at this date or over the 12 months to this date depending on the type of data).[1] This would reduce the data collection burden across the industry by removing requests for other dates.

---

[1] There may be good reasons for trustees to report data at a different date, eg if the scheme's investment strategy changes significantly between 31 December and the end of the reporting period.

In relation to metrics, "as at 31 December" does not mean that the data for underlying assets must be at that date. A typical interpretation is:

- Portfolio holdings and weights at 31 December; and
- Latest data available for each holding when the metric is calculated.

We believe this approach would:

- reduce the volume of reporting required each year, as one report would be applicable for multiple use cases across multiple regulatory bodies
- focus regular reporting on high-quality evidence of implementation, especially if there's guidance to limit the quantity of detail.

We acknowledge that multiple government departments and regulators are responsible for the different elements. Therefore, we suggest gradual implementation, starting by allowing schemes to combine two or more of their existing reports, harmonising the requirements over time.

Principles for sustainability reporting guidance
Here we set out our high-level preferences for guidance on the sustainability reporting framework.

- Guidance from different bodies should be consistent and not overlap. Guidance on a particular element of sustainability reporting should be provided by DWP or TPR, but not both.[1]
- Guidance relates to mandatory elements only, including outline structure for the reporting,[2] to support comparability between schemes and an indication of the detail expected.
- Guidance is principles based, with some supporting detail.
- Guidance seeks to limit the amount of detail disclosed and encourage quality over quantity. For example, guidance could suggest that schemes report a few high-quality case studies.
- If any further detail is felt necessary, or guidance on voluntary elements, this should be clearly distinguished from the main guidance and positioned as additional or educational material, i.e. "may" not "should".

Regulation of sustainability reporting
It's important that the oversight of mandatory sustainability reporting encourages the intended behaviours. We'd like enforcement action to be based on whether trustees have followed the spirit of the rules. We recognise that this would mean changes, e.g. to current regulations imposing mandatory TPR fines for technical breaches of reporting rules.

Relevance to other types of investors
Any changes that simplify trustees' own sustainability reporting should not reduce its quality. This is most relevant for reporting requirements that apply to multiple types of investors, such as the Financial Reporting Council's (FRC) UK Stewardship Code. We would not want the reports produced by others, such as asset managers and service providers, to become less useful for trustees. We suggest that bodies such as the FRC differentiate between commercial and non-commercial entities when setting their sustainability reporting requirements.

For example, when calculating the carbon footprint for a portfolio of publicly listed companies, the emissions data for underlying companies is likely to relate to various different 12-month periods.

[1] For example, TPR's General Code of Practice could set out expectations for the stewardship policy and DWP statutory guidance could cover the annual reporting on its implementation. Both would be consistent with the FRC's Stewardship Code, which would set out more advanced expectations for both the policy and the annual reports.

[2] For example, based on the four TCFD pillars (governance, strategy, risk management, metrics and targets).

Focus Area 2 – Facilitating action on sustainable investing

Our ambition
We aim to use direct dialogue with policymakers and regulators to remove barriers to sustainable investing for pension trustees. More broadly, to seek a regulatory framework and policy guidance that facilitates such action.

Delivery through two routes
Our activities will be both **tactical**, i.e. responding in the short term to particular opportunities for influence and requests for input from regulators such as participation in consultations and roundtables, and **strategic**, meaning areas in need of long-term change or development.

Strategic route
There are three current topics that fall under this banner:

- *Double materiality* – shift the emphasis of pension scheme sustainability requirements from single materiality (i.e. considering only the impact of sustainability on the investment portfolio) towards double materiality (i.e. considering how an investment portfolio has a sustainability impact upon the real world). Initially we will seek to ensure that the climate-related metrics required for TCFD reporting incorporate sufficiently forward-looking elements that encourage trustees to take real-world action, using DWP's review of the TCFD requirements[1] and/or adoption of a transition plan approach[2] to enable this.

- *Trustee knowledge and understanding* – ensuring that trustees and others have adequate knowledge of sustainable investment, e.g. best-practice integration of sustainability across different asset classes, the relationship between sustainable investing and fiduciary duty, and the importance of stewardship and engagement. This could be achieved through talks at industry conferences and web-based resources, including TPR's Trustee Toolkit. Our preference is for sustainability to be integrated where relevant, rather than treated as a standalone topic.

- *Assurance of sustainability reporting* – facilitating assurance of sustainability reporting by managers, so that trustees have greater confidence in the reporting and can focus on the actions to respond to the insights it reveals.

Tactical route
Our three short-term projects are:

- *Fiduciary duties* – supporting trustee understanding of fiduciary duties following the publication of the FMLC paper on the issue, so that they feel empowered to take appropriate action on climate and other sustainability risks.

- *UK Stewardship Code* – maintaining a focus in the FRC's review of the Stewardship Code on trustees' actions in this area. This means that managers' reporting needs to facilitate

[1] As set out in The Occupational Pension Schemes (Climate Change Governance and Reporting) Regulations 2021, as amended

[2] The Labour Party's 2024 manifesto included the introduction of mandatory transition plans for UK pension schemes

effective oversight by trustees and provide a basis for them to challenge managers on more outcome-oriented activity.

- *DWP review of stewardship guidance* – maintaining a focus in any review of stewardship guidance (such as regarding SIPs and Implementation Statements) on the actions that trustees seek to take in this area – e.g. challenging managers to increase their focus on real-world outcomes.

We will do this by working with regulatory bodies to aid their understanding of the barriers which exist in all three areas currently and by working with other groups in the industry e.g. Climate Financial Risk Forum (CFRF), Glasgow Financial Alliance for Net Zero (GFANZ) etc, with the aim of:

1. Producing clear guidance for trustees, including examples of what the FMLC paper indicates is permitted and identifying where the boundaries of fiduciary duty sit.

2. Identifying areas where trustees can effectively challenge managers on real-world outcomes, e.g. the extent to which engagement is having effect, and provide guidance and examples of credible steps trustees can take to invest more sustainably and drive real-world outcomes.

3. Pushing for and assisting in the delivery of practical and helpful frameworks (including for smaller schemes) by regulators to support the above two ambitions.

4. Working with regulators and the asset management community through existing groups and dialogue to remove barriers to decision-useful and reliable reporting which will assist trustees in setting, monitoring and driving targets to meaningful real-world change.

Focus Area 3 – Investment into illiquid sustainable assets

Introduction

Pension scheme capital represents an important source of finance for the economy's sustainable transition, with the market value of private sector DB and hybrid pension schemes reaching almost £3trn towards the end of 2023.[1] There are also significant sustainability opportunities in the illiquid universe: an estimated $275trn of investment in physical assets is required globally to reach net zero by 2050, for example.[2] Investing in the sustainable illiquid universe usually involves new capital, which offers scope for additionality and impactful stewardship. Such opportunities are also consistent with the UK government's goal to unlock new investment for the UK economy and boost returns for savers.[3]

We've identified key barriers to greater investment in illiquid sustainable assets for DC and DB schemes, respectively.

For DC schemes:

We note the steps already taken to improve access to illiquid assets through LTAFs. However, uptake remains limited due to a lack of awareness of the potential benefits, governance/bandwidth constraints, the need to update provider systems to accommodate illiquidity, competitive/union pressures to keep costs low, and a tendency to interpret 'value for money' as 'low cost'. We believe greater clarity from regulators could encourage trustees to phase sustainable options into default funds that allow for similar risk/return characteristics for the overall portfolio, but increase the overall sustainable outcome.

For private sector DB schemes:

We believe the primary barrier to greater investment in less-liquid assets is the tendency of DB trustees to focus on insurance-based endgames. Illiquid assets are not generally accepted by insurers, so insurance-based objectives preclude investment in less-liquid assets. We've identified two areas for action:

1. Exploring ways to enable and incentivise insurers to accept illiquid assets from DB schemes as part of insurance transactions (e.g. through *in specie* transfers), while staying within the guidelines of the Solvency UK regulatory framework. This would lessen the drive for trustees to target a terminal portfolio of highly-liquid assets.

2. Incentivising schemes to consider a 'purposeful' run-on objective as an alternative to insurance-based objectives. We note that recent steps like the reduction of the authorised surplus payment charge from 35% to 25% have already prompted greater interest in this.

[1] 20240909-ppi-pension-scheme-assets-main-report-final.pdf (pensionspolicyinstitute.org.uk)

[2] the-net-zero-transition-what-it-would-cost-and-what-it-could-bring-final.pdf (mckinsey.com)

[3] Pensions Investment Review: interim report, consultations and evidence - GOV.UK

Some secondary market funds have begun to take on illiquid investments from schemes looking to exit as they approach buy-in/buy-out. A fund that collectively pools sustainable assets could provide liquidity and reduce the barriers for DB investors.

More generally, policymakers could consider the role of pension schemes in financing the UK's sustainable transition, and whether this merits creating public-private co-investment opportunities or tax breaks. If the UK government introduces mandatory transition plans for pension schemes, we believe trustees should be required to consider investing in climate solutions.