Introduction

The UK’s financial institutions have a critical role to play in how we meet – or miss – national and global net zero targets. Where the £3 trillion invested by UK pension funds go will have a significant impact on both the kind of world we retire into, and the potential returns available to savers from those pensions.

While a raft of net zero commitments have been made by the pensions industry in recent years – and climate action has become a central pillar of many leading schemes’ investment strategies – substantial amounts of pension holders’ money remains invested in the fossil fuel industry.

The fossil fuel industry is responsible for the majority of global emissions and is made up of companies embroiled in allegations involving human rights violations, anti-climate lobbying, disinformation campaigns, deforestation, and oil and gas expansion – the latter something the UN, the International Energy Agency and thousands of leading climate scientists have said is incompatible with keeping within 1.5 degrees of global warming.

As the fossil fuel industry faces growing backlash from citizens for its role in the climate emergency, and pension funds find themselves under increasing pressure to drive emissions reductions in their portfolios and investee companies, how investors understand and engage with the fossil fuel industry has become one the defining features of if – and how – the world transitions to a net zero economy.

“A disorderly climate transition caused by delayed action will not only miss the goals of the Paris climate agreement but directly work against the financial interests of pension funds and other long-term investors and their beneficiaries.”

Adam Matthews
May, 2023
Chief Responsible Investment Officer at the Church of England Pensions Board
Given the impact of fossil fuels on people, planet, and our pensions, Make My Money Matter – in collaboration with sustainability research agency Route2 – has undertaken new research to estimate the total exposure of UK pension schemes to fossil fuel investments.

We hope this report raises widespread awareness amongst the public of the links between our pensions and fossil fuel companies, and encourages robust, escalated, climate-focused action from UK pension providers on this issue.

This document outlines the approach this research followed, provides key findings from the analysis, and concludes with a series of recommendations relating to UK pension schemes’ investments in, and engagement with, the fossil fuel industry.

“The findings of the World Benchmarking Alliance’s Oil and Gas Benchmark 2023 highlight a massive gap in corporate accountability in the sector. It found that within the keystone companies assessed, none have committed to halting the expansion of fossil fuel activities before 2030. Global energy-related CO2 emissions hit a new record in 2022, and the majority of emissions linked to oil and gas products come from the use/combustion of products. Thus, reducing oil and gas production and demand is by far the most efficient way to see sectoral emissions decreasing.”

Katharina Lindmeier
June, 2023
Senior Responsible Investment Manager at Nest

Vicky Sins
June, 2023
Decarbonisation and Energy Transformation Lead, World Benchmarking Alliance
To estimate the fossil fuel investments of the UK pensions industry, a 2-step process was followed.

First, the total and composition of assets under management (AUM) within the UK pensions industry was identified. Within this, those assets most likely to contain fossil fuel investments were selected. Those asset classes included listed equities and corporate bonds, and made up roughly one third of the UK pension market. These became the ‘in-scope’ assets for analysis (see Figure 1 below).

From here, those ‘in-scope’ assets were analysed for their fossil fuel exposure. This analysis combined a bottom-up approach (which assessed disclosed information on fossil fuel investments from representative funds in a sample of UK pension schemes), and a top-down analysis (which applied benchmark fossil fuel exposure from leading indices to determine fossil fuel investments in undisclosed investments).

These findings were combined, weighted, and extrapolated to create an estimate for UK pension industry investments in the fossil fuel industry.

A full breakdown of the methodology followed can be found in the appendix.

*Other Assets include private equity, property, cash, money market, etc.*

**Figure 1. Composition of UK Pensions Investments: ‘In and Out of Scope Assets’**
UK pension funds are estimated to invest over £88 billion into the fossil fuel industry.

This translates to an estimated average of £3096 per UK pension holder.*

This £88 billion of investment is equivalent to 10 times the current value of total investments in listed FTSE 350 stocks predominantly involved in clean energy.

While 70% of the representative funds in the schemes analysed disclosed Shell and 60% disclosed BP among top holdings, not one renewable energy stock was listed.
Fossil fuel investments held by climate conscious investors have long been considered a mechanism by which to exert pressure on individual companies to reduce their emissions.

While in theory investors have power to bring change and accountability to their investee companies through their stewardship and voting practices – and there is space for the fossil fuel sector to play a critical role within a just transition to net zero - there is little evidence to suggest that either investors are acting with enough strength or ambition on this agenda, or that the fossil fuel sector is transitioning with the speed and urgency required.

Failings of the fossil fuel sector’s climate and transition strategies

Despite years of opportunity to lead the clean energy transition, large oil and gas companies remain focussed on short-term profit maximisation and fossil fuel extraction.

Analysis shows that while the fossil fuel industry is responsible for the majority of global emissions, no major oil and gas company has committed to ending new fossil fuel expansion – something the International Energy Agency states is critical to preventing the worst effects of climate change. In fact, instead of ruling out expansion, the likes of BP and Shell – two of the companies found in the majority of pension fund holdings– have reversed and watered-down climate commitments; focusing on short term profit maximisation over long term sustainability.

Such action undermines the Paris goals to limit warming to 1.5 degrees, and when combined with further inadequacies within oil and gas company transition plans – such as many not including interim scope 3 absolute emission reduction targets, or having an over reliance on unproven carbon capture and storage technologies and unrealistic carbon offsets – means they are failing to deliver a rapid transition to net zero. As a recent report from Net Zero Tracker outlines, many of the climate plans of fossil fuel companies are ‘largely meaningless’.
Furthermore, according to the IEA, in 2022 just 1% of the oil and gas industry’s cash spending went on investment in clean technologies.

Put together, there is a clear picture of an industry failing to respond to the climate emergency, an industry focussed on short term profits over long term sustainability, and whose action – or lack thereof – poses clear and imminent risks for both people and planet.

Failings of investor engagement with investee companies

Despite the clear failings of major oil and gas companies’ climate and transition strategies – and the raft of net zero pledges and climate commitments from leading pension schemes – the UK pensions industry remains heavily invested in fossil fuel companies.

Our analysis shows that over £88 billion of UK pension investments goes towards the fossil fuel industry.

This represents almost 10% of equity and corporate bond holdings of the entire pensions industry. These investments are supporting businesses which have so far shown themselves unwilling, or unable, to adapt their business models, and act with the pace and scale required to tackle the climate emergency.

In fact, as shown by the recent actions of BP and Shell, many are...
rolling-back on climate commitments rather than increasing their ambition.

While there has been much pension fund engagement with the fossil fuel industry in recent years, current approaches have proved too weak and ineffective in the context of a growing climate emergency and the increasing intransigence of oil and gas companies.

Not a single major UK pension provider has set red lines on investing in companies which continue to explore and develop new oil and gas – despite clear guidance from the IEA - and only a handful of schemes publicly voted against leading fossil fuel companies in the 2023 AGM season, irrespective of the clear shortcomings in their climate plans.

For pension funds, this is inconsistent with their public positions on climate change, while for savers, it means that the money in our pensions – while supposedly saving for our futures – continues to be invested in companies which are in fact jeopardising them.

Beyond the environmental implications - and the potential inconsistencies with pension schemes' net zero strategies and climate commitments - the fossil fuel industry’s short-term focus brings mid- and longer-term risks for pension funds.

By investors supporting businesses which are misaligned with global climate goals, it increases the chances of a disorderly transition, and generates further risks amongst the other assets those investors hold. Furthermore, in a rapid net zero transition, those fossil fuel investments are themselves placed at risk of devaluation, with billions invested in companies whose strategies are threatened by climate litigation, stranded assets, and customer backlash.

As a result, we believe that ongoing investments in fossil fuel companies by the UK pensions industry – without a serious, time-bound and co-ordinated escalation in how investors use their stewardship role – represents a ticking time bomb for both our pensions and the planet.
Recommendations

To address this imminent environmental and financial risk, Make My Money Matter is calling on UK pension providers – alongside all investors and asset managers - to take immediate, and time-bound action on the fossil fuel companies they are invested in. This includes:

1. Putting fossil fuel companies on notice that they are expected to rule out new oil and gas expansion and set credible 1.5 degree aligned plans.

2. Voting against any company which continues to develop new oil and gas, and which doesn’t have credible 1.5 degree aligned plans.

3. Divesting publicly – within set timeframes - from those fossil fuel companies who fail to respond urgently to steps 1 and 2 above.

By taking these steps – including setting clear time limits to their engagement - the pensions industry can put real pressure on the fossil fuel industry to drive emissions reductions, while better protecting the assets of their members from the financial and environmental threats of climate change.
Appendix: Full Methodology, Findings and Limitations
Full Methodology

This analysis was undertaken by sustainability research agency Route2 and followed the below methodology.

To estimate the fossil fuel exposure of the UK pensions industry, a 2-step process was followed:

1. **Step one involved two stages**

   **First**, assessing the assets under management in the UK pensions industry. The total figure identified was £2.9 trillion, which comprises £2.2 trillion of funded occupational pension schemes (Office for National Statistics (ONS) 2023), and £0.7 trillion of Defined Contribution (DC) contract-based pension schemes (Principles for Responsible Investment (PRI 2019)).

   **Second**, this total was segmented by asset class, with a particular focus on the direct and pooled investments in listed equities and corporate bonds - those assets most likely to have direct exposure to fossil fuels and where data is more available. This amounted to £935 billion out of the total £2.9 trillion, and became the scope of our analysis.

   ![Figure 1. Composition of UK Pensions Investments](image)

   *Other Assets include private equity, property, cash, money market, etc.*
The bottom-up approach identified ten leading Defined Benefit (DB) and Defined Contribution (DC) schemes based on their AUM and data availability. The most representative fund(s) of each scheme was identified, and the disclosed top-holdings were used to derive the fossil fuel exposure for the % of the fund covered by these top holdings.

The bottom-up analysis was supplemented with a top-down approach for the % of the funds not covered by top holdings. This method applied the benchmark exposure to fossil fuels from the FTSE 350 and FTSE All Share to represent domestic securities, and the MSCI World ex UK and MSCI All Country World Ex UK to represent overseas securities. These indices were selected based on their common usage within the industry.

The top-down and bottom-up calculations were integrated at fund level and geographic exposures (UK/non-UK) for the top-down weightings were aligned with the macro-level exposure of the UK pensions market.

Finally, the fossil fuel exposures for each fund were combined in an equal-weighted manner to derive an estimated percentage of fossil fuel exposure.

Once steps 1 and 2 were complete, this data was used to estimate total pension industry fossil fuel exposure. This was also calculated on a per pension holder basis.

*From an individual basis, the industry exposure figure was divided by the number of non-retiree adults with a pension in accumulation (estimated 28.5m) to achieve a per pension holder figure for investment in fossil fuel of £3,096.
The main results and findings are summarised below:

<table>
<thead>
<tr>
<th>UK Pension Funds &amp; Schemes</th>
<th>Total Amount (£ Billion)</th>
<th>FF Exposure (%)</th>
<th>FF Exposure (£ Billion)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Listed Equity Holdings</td>
<td>700</td>
<td>9.48</td>
<td>66.4</td>
</tr>
<tr>
<td>Corporate Bond Holdings</td>
<td>235</td>
<td>9.24</td>
<td>21.7</td>
</tr>
<tr>
<td><strong>Total (in scope)</strong></td>
<td><strong>935</strong></td>
<td><strong>88.1</strong></td>
<td></td>
</tr>
</tbody>
</table>

**Assumptions & Limitations**

This report examines the exposure to fossil fuels in the listed equity and corporate bond holdings (£935 billion) of UK's funded occupational pension schemes and DC contract-based pension schemes (total AUM of £2.9 trillion). While data for the funded occupational pension schemes is available from Q3 2022, for DC contract-based schemes the most recently available data was from 2019. Therefore, the AUM of £653 billion applied for contract-based schemes is only accurate as of 2019.

Within this analysis, only investments in listed equities and corporate bonds, which represent 32% of the total assets under management of the UK pension industry, have been considered. Other less well-defined asset classes have been excluded due to a lack of transparency or relevance, meaning the overall fossil fuel exposure of the entire UK pension industry may be higher.

The limited data on holdings within schemes means that estimates and extrapolations have been made in place of publicised information.
This includes by applying representative benchmarks and appropriate geographic splits to determine non-disclosed holdings.

Notably, a lack of transparency was seen among the corporate bond holdings. Amongst the selected funds, seven had holdings in corporate bonds, however, only two disclosed details on the top holdings.

To estimate the fossil fuel exposures of the market indices, only direct investments in fossil fuel stocks were considered. Companies were identified as 'fossil fuel investments' by research into their primary business line and alignment with the Oil, Gas and Consumable Fuels industry using the classification structure provided by GICs. Other companies heavily involved in fossil-fuel activities, such as those with a significant proportion of their revenues generated by providing Oil and Gas related services, such as Petrofac and John Wood Group, were not included.

Likewise, investments in fossil fuels made through investment trusts, pooled funds, and other indirect investments were excluded from the index fossil fuel calculation. This includes listings on the FTSE 350 such as Edinburgh Investment Trust and JPMorgan Global Growth & Income Trust, which are likely to have fund holdings in fossil-fuel companies. Similarly, the research does not include large banks, many of whom have significant investments in the fossil fuel industry, and which many pensions are heavily invested in. For example, many leading UK pension schemes are likely invested in Barclays, Europe’s largest funder of fossil fuels since 2016.
Detailed Industry Asks

- Publish clear stewardship expectations that investee fossil fuel companies must:
  - Stop expanding fossil fuels (exploration and development of new oil and gas)
  - Have credible 1.5 degree (low/no overshoot) aligned plans, including scopes 1-3 absolute emission reductions this decade
- Set out red-lines in your voting/expression-of-wishes policies stating that you will vote against companies that don’t meet these expectations
- State that you will also deny new debt finance to companies that don’t meet these expectations
- Communicate your expectations, and escalation intentions (including divestment if no action), to investee fossil fuel companies and asset managers
- Show leadership by speaking out publicly - including ahead of key AGMs - and by collaborating with other asset owners for robust joint action on high emitters in order to increase shareholder pressure
- Vote against directors, plans, and auditors of any company which continues to develop new oil and gas and which does not have a credible 1.5 degree aligned plan
- As a default, support climate resolutions calling for an end to fossil fuel expansion, and credible 1.5 degree aligned plans
- Where you hold shares in banks, vote against the company if it is directly financing new oil & gas projects, or if it does not require fossil fuel clients to have credible 1.5 degree aligned plans
- Where you hold shares in insurers, vote against the company if it is insuring new fossil fuel projects
- Hold your asset managers to account for voting per your expectations, and escalate if they don’t
- Divest holdings from fossil fuel companies which do not respond to the above steps within a set timeframe

Data Sources

- ONS – Funded occupational pension schemes in the UK.
- Principles for Responsible Investment (PRI) – Private Retirement Systems and Sustainability: United Kingdom.
- ONS - Estimates of the population for the UK, England, Wales, Scotland and Northern Ireland - Office for National Statistics (ons.gov.uk)