Better pensions for all and a sustainable, productive, economy:

Proposals for reform

Pensions reform is high up the political agenda, with a focus on how to incentivise pension funds to invest more in the UK. We agree that this is important. The power and potential role of pensions in delivering broader improvements to the economy, society and the environment are also on the agenda for campaigners, businesses and civil society organisations. It is crucial that pensions policy reform ensures that all citizens can look forward to adequate pensions throughout retirement, and that pension fund investments help us to achieve a just transition to a truly sustainable and productive economy.

This paper sets out a medium-term programme for reform that can deliver on these interlocking objectives, including recommendations that can be taken forward in the short-term. It is designed to create a pension system that delivers adequate and secure incomes in retirement for all, and that leads to a step-change in long-term and green investment by pension funds that will boost the productivity and sustainability of the UK economy. It has been developed based on the expertise of the contributing organisations, and a year-long process of discussions with experts from the pensions industry and beyond. These recommendations will form the basis of public campaigning, industry advocacy, and policy and regulatory work over the coming years to achieve systemic changes in our pension system.

The significant problems we face:

Most UK citizens are expected to receive retirement income from two types of pension: a state pension and a private, occupation-linked pension. Unfortunately, these will not add up to an adequate or secure income in retirement for the majority of the population, in particular lower paid workers. The state pension is low in comparison to many peer countries, though it is being gradually improved by the triple lock. However, many people still do not receive the full state pension because they have not built up enough years of National Insurance contributions, which is particularly a problem for women and the self-employed.

In addition, the private, occupation-linked pensions system delivers extremely unequal outcomes, despite increases in coverage thanks to the welcome introduction of automatic enrolment. The majority of the working-age population is now covered by Defined Contribution (DC) pension schemes, in which incomes in retirement are directly linked to individual and employer contributions during a working life. However, one recent research paper estimates that over 80% of people enrolled in DC schemes are not saving enough to achieve what the public believes to be an acceptable level of income in retirement.[1] The inequality at the heart of the system is shown by the fact that the bottom half of the population holds just one per cent of total pension wealth, according to the Office for National Statistics (ONS).[2] On average, women are currently forecast to receive private pension pots in retirement that are one third lower than those men will receive.[3] To make matters worse, the current default DC model means that individuals are exposed to – and responsible for managing – very significant risks. These include longevity risk – living longer than their pension pots allow a decent income for – and investment risk – the risk of declines in value of those pots due to the performance of the fund they are invested through. This is worrying given that levels of financial capability among the public in the UK are low compared to comparator countries.[4]

The insecurity at the heart of the UK pension system is magnified by the fact that current climate and environmental trends would lead to a bleak, insecure later life for all future pensioners. Given the economic destruction that current climate change trends would entail, and potential major impacts on the financial sector of a badly managed transition, pension savers also risk a catastrophic collapse in the value of their pensions savings at some point in the future. Sadly, pension funds are not yet investing enough in powering the just, green transition that can save us from this fate. In fact, they are often pointed in the wrong direction. £300 billion of UK pension capital is invested in companies with a high risk of driving deforestation[5] and UK pension funds have invested over £88bn in the fossil fuel industry, ten times the current value of total investments in listed FTSE 350 stocks that are predominantly involved in clean energy.[6]

Finally, the system is not investing enough in the UK economy, and has tended towards a shorter-term investment horizon, when what the UK really needs is long-term investment for a sustainable future. At the heart of this problem is that most Defined Benefit (DB) schemes – which used to be the main model and still own a majority of pension fund assets – are winding down, and thus investing in safe, lower-risk and lower return assets. This is compounded by the fact that the now-dominant DC schemes that replaced DB pensions tend to invest in liquid assets that are easy to sell rather than making longer-term investments, and can risk a focus on reduced costs rather than higher growth returns. DC schemes place the burden of risk onto each individual pension saver, who is then assumed to prioritise safety and security more highly than longer-term growth.

All of these problems are exacerbated by a lack of transparency and accountability throughout the system, contributing to inertia and poor collective outcomes.

The solutions:

Thankfully, sensible, practical changes can rectify these problems, and the ambition of both major political parties to undertake significant reform is welcome. We believe that the deep-seated failings of the pension system summarised above require a far-sighted programme of reform, which should be developed in consultation with pensioners and pension savers and their representatives, trade unions, the pensions and financial sector and civil society groups. The proposals for reform set out below provide the required level of ambition and practicality and we offer them as a contribution to such a process. They should be seen as a package that aims to meet the interlocking goals of the pensions system highlighted above. Delivering these reforms would help grow the economy, tackle the climate emergency and help deliver adequate and secure pensions for all UK citizens, future-proofing their pensions and savings.

1. Boost pension savings and the state pension to ensure adequate retirement incomes for all and support a fairer, stronger economy

People have a right to expect the pensions system to support them to save enough to enjoy their retirement, and that the state pension will provide an adequate backstop if they can't.

It is clear that any reform of the private pensions system will need to significantly boost pensions savings, particularly those of the lower paid. The Pensions Commission's target of 15% of income as the minimum contribution, or other suggestions of a 12% target would be a significant improvement on the current 8% minimum.[7] Given that increasing employee contributions is likely to also increase the numbers who opt out - particularly those at the lower end of the income scale - and that employer pension contributions fell significantly for those that transitioned from DB to DC schemes, it is reasonable to expect employers to pay most of any such increase.

However, it will also be important to make the private pension contribution system progressive if it is to meet the needs of those living on low incomes who will struggle to build up sufficient contributions even at higher percentage rates of contribution. This can be achieved by ensuring there is a mandatory minimum absolute amount of employer contribution, set at a level that would deliver a sufficient pension pot over a lifetime. The cost to employers could be offset by reducing the minimum contribution requirements for those on higher incomes. The Living Wage Foundation has developed a Living Pension scheme for employers that ensures minimum pension contributions for all employees, benchmarked as a percentage of the living wage.

Bringing the millions who currently have no occupation-based pension savings into the system is also critically important. People living on very low incomes who are currently ineligible for auto-enrolment, the self-employed, and those who cannot work - due to caring responsibilities for example - are currently significantly disadvantaged. Women are overrepresented in these groups, and other characteristics such as disability or ethnicity are also correlated with lower pension savings. The additional cost of doing this could be offset in part by reforming the tax reliefs on private pension contributions which disproportionately benefit higher earners, and which were worth £48bn in 2020/21.

Finally, the state pension should be designed to ensure an adequate income in retirement for those unable to save enough through the private system. The triple lock is doing a good job of gradually improving the UK's comparatively low level of state pension, but many people still don't receive the full state pension because of insufficient years of National Insurance contributions. This is a situation which does not occur in some other OECD countries, where years of residency are used as the benchmark for full entitlement instead.

Improvements such as these to support pensioners and pension savers will also have significant economic benefits. Boosting pension savings rates will generate larger pools of capital that can be used for investment, and increasing the spending power of pensioners will also have significant positive economic benefits.

Key recommendations for government:

i. Boost overall pension savings by increasing the mandatory minimum level of pension savings to 12% or more, with a 5% contribution from the employee and 7% from the employer, with decreased mandatory employer contributions for earnings above a certain level such as the top income tax threshold.

ii. Make default pension contribution rates more progressive, for example by mandating minimum absolute levels of employer contributions set at adequate levels.

iii. Maintain the triple lock, and consider ways of ensuring those who don't currently receive the full state pension can do so, such as using years of residency as the benchmark for eligibility.

iv. Include those who are currently excluded from private pension savings by reviewing auto-enrolment or a similar option for the self-employed, and investigating how contributions for those unable to work can be boosted.

2. Make default pension funds longer-term investors

With over £3 trillion in assets, UK pension funds are major investors. However, the investment time horizon of most pension funds is not well aligned to the long-term interests of the economy or their beneficiaries. DB schemes that are closing are understandably focussed on safe assets. As noted above, DC schemes – the default option for new joiners – also tend to invest in liquid assets rather than making longer-term investments, and can focus on reduced costs rather than higher growth returns. However, there are ways of altering this approach; for example, some schemes use staged models to take higher risks when beneficiaries are young and then reduce the riskiness of investments as they approach retirement. Collective Defined Contribution (CDC) schemes, recently introduced in the UK, offer an alternative that aligns the promise that the pension fund makes to its members with a longer-term investment horizon. CDC schemes collectivise longevity risk,[8] and make a qualified promise to pay out a certain income in retirement, subject to change and depending on contributions. They can therefore pool the assets of all their beneficiaries and have a balanced, longer-term investment approach, incentivised by the need to ensure sufficient returns to meet their qualified promises to members. Open DB schemes also share the same advantage, so any consolidation of the industry should aim to maintain DB schemes and expand them if possible.

Key recommendations for government:

i. Ensure that default pension options are focussed on long-term investment and reducing longevity and other key risks for savers. This could mean:

a. Examining ways of baking in longer-term investment horizons and better protection from risks across all existing DC schemes.

b. Examining ways of ensuring open DB schemes remain and, if possible, grow.

c. Expanding Collective Defined Contribution (CDC) pensions and allowing existing schemes and members to transfer to CDC schemes if they wish, including through any consolidation process (see below).

3. Support pension funds to drive green investment in the UK

The pensions system, already very large, will grow significantly in the coming years, especially if widespread calls for increased contributions levels are heeded. This expanding system could provide much of the capital needed to meet the UK's low-carbon investment gap: the Climate Change Committee estimates that we need to increase our annual low-carbon investment from £10 billion in 2020 to around £50 billion by 2030.[9] Currently, however, only 4% of the pension industry's assets are invested in climate solutions. A recent report by Phoenix Group and Make My Money Matter found that the UK pensions industry could invest £1.2 trillion by 2035 in UK climate solutions if key barriers were removed and policy changed to support this.[10] At the same time, the significant damage that pension investments are doing to our climate and environment through support to fossil fuels, deforestation and other environmental destruction must be stopped. All future pensioners will directly benefit from collective efforts to prevent damaging climate change and nature destruction, which would de-value their retirement savings and undermine future well-being. This would also prevent pension funds being hit by a substantial loss of value due to fossil fuel assets becoming "stranded" as the green transition leads to a reduction, and potentially a collapse in their value.

At the same time, the economy and the economic prospects of pension savers as a whole would benefit from a coordinated step-change in green investment in the UK. Pension funds could provide much of the capital for this, but they will need to have a supportive economic policy framework to do this, including: an overall UK transition plan, with sector-specific strategies; long term policies that drive change in energy and other key sectors; supporting larger or riskier investment through aggregation, co-investment or guarantees; and setting overall financial sector policies to help support the just, green transition. Such a framework would provide the basis for agreeing an ambitious scale up in investment in climate and nature solutions.

Key recommendations for government:

i. Ensure an effective overall economy-wide just transition strategy, with sector-by-sector plans focussed on long-term investment needs, and support for such investment through policy frameworks and public investment plans.

ii. Agree ambitious plans to scale up green pension fund investment in the UK through a range of measures such as: expanding green funds or institutions like the UK Infrastructure Bank and green assets such as green bonds; using risk-sharing mechanisms between investors and government; developing initiatives that accelerate the take-up of new technologies and the aggregation of fragmented opportunities. Ensure policy frameworks that support this, such as the Green Taxonomy, are robust.

4. Green the system and phase out fossil fuel investment

The International Energy Agency's Net Zero by 2050 Roadmap shows that there simply is no room for new fossil fuel expansion if we are to stay within safe climate limits.[11] Sadly, the pensions industry continues to fund fossil fuels and nature destruction, as noted above. Furthermore, recent Carbon Tracker research shows that pension funds and their advisors have incomplete or limited understanding of climate science and the potential impacts of climate change, and the risk models they use are therefore built on false assumptions.[12] This is worrying, given that future pensioners bear very direct personal risks from climate breakdown, and also significant financial risks. The same is true for nature risks caused by the biodiversity crisis and widespread ecosystem damage. These impacts will increase as efforts to tackle the climate crisis continue to ramp up, with an increasing share of fossil fuel assets at risk of losing their value, potentially rapidly.

The requirement for asset managers, regulated asset owners and listed companies to publish transition plans aligned with the government's net zero commitment is welcome, as is the Transition Plan Taskforce's efforts to improve disclosure frameworks. However, the practical impact of this initiative will be weakened if standards are not set at the appropriate level and across the whole financial system, if it is too easy to evade taking serious action, and if the mechanisms to drive high standards are not strong enough. Better disclosure alone will not drive change of the scale and speed that is needed.

We also know that such environmental and social factors have a direct impact on the wellbeing of pension savers. For example, pension investments can be directly linked to corporate activities that impact public and worker health, through air quality impacts for example, and worker rights, such as an investee company's stance on the living wage. These impacts affect savers both directly and indirectly through their effects on long-term financial return. However, the current definition of trustee fiduciary duties doesn't allow these vital factors to be fully accounted for in investment decisions.

The pace of change in the industry is very slow and must be accelerated. Of the 20 providers in Make

My Money Matter's 2024 Climate Action Report, only 3 were scored as "adequate" overall, with 17 being either "inadequate" or "poor". Importantly, all of the providers were either inadequate or poor on fossil fuels, and deforestation & land-use. This reflects findings that – for example - none has a clear public policy on excluding companies engaged in new oil or gas exploration or development, and there is a lack of comprehensive policies on deforestation & land-use.[13]

Key recommendations for government:

i. Require all pension funds and other financial institutions to adopt science-based 1.5C aligned mandatory transition plans.

ii. Ensure that standards for these transition plans are high, which means that they should include no assets or investments that include plans for fossil fuel expansion.

iii. Support pension fund trustees to better integrate climate and nature risks in their decisions through understanding the role of the fund as a universal owner. Trustees should also recognise their role in driving effective investment stewardship, including around climate and nature action to protect member interests.

iv. Start the process of reforming the fiduciary duties of pension trustees by codifying the findings of the Financial Markets and Law Commission's guidance on trustees' fiduciary duties in law. In particular, this should include immediate guidance from DWP around what actions are permissible and expected for trustees to take, ahead of a legal redefinition of beneficiaries' 'best interests' to include social and environmental factors alongside financial return.

v. Drive improvements in risk assessment to ensure that pension funds, and their advisors and agents: properly consider the risks of climate change and nature damage; integrate the latest climate science; and embed the very high levels of uncertainty that we face in their risk frameworks.

vi. Tackle the UK finance sector's links to deforestation by enacting mandatory due diligence for all financial institutions including pension funds, and mandatory delivery of the recommendations of the Taskforce for Nature Related Financial Disclosures.

vii. Give the Pensions Regulator and other relevant regulators statutory mandates to embed climate and nature in their regulatory and supervisory operations, to ensure that they carefully consider the climate and nature impacts of the rules they set.

5. Enhance transparency and accountability

All the above reforms would be enhanced by ensuring actors throughout the pensions chain are more transparent, and by increasing accountability to members and the general public. Pension fund investments influence the lives of beneficiaries in many ways: their health, their access to information and technology, the food they eat, the clothes they wear, the culture they consume and the quality of air and water they breathe and use. Over the decades that people save into a pension scheme, companies they invest in will be making decisions year after year that have some bearing, for good and ill, on their quality of life and the risks to which they are exposed exposed through life's journey. Pension savers in the UK, however, are largely cut out of the picture when it comes to influence and power over investments made in their names, despite them taking on the risks connected with owning investments.

There are a large number of good proposals that need to be considered carefully, which include, for example: requiring fund managers to give information to pension schemes on the exercise of all voting rights on their behalf in a standard format; mandating worker representatives, member-nominated trustees or advocates for ESG issues on pension boards; mandating compulsory pension scheme AGMs; making it easier for members to switch providers if they are not satisfied; and requiring better transparency and disclosure throughout the pensions chain, including for asset managers and advisors.

Key recommendations for government:

i. Ensure that pension schemes have a duty to ascertain the views of members. Schemes already have legal duties to act impartially and prudently in the best interests of members through their fiduciary duty. Without ascertaining members' views, preferences and priorities, scheme decisions makers are not fully equipped to fulfil these core legal duties. There could be considerable flexibility in how to ascertain members' views but schemes should have to do so, explaining their approach and being transparent to the membership at large about what they have learned

ii. Improve the accountability and transparency of pension funds to members. Provide standardised information to pension fund members and employers on the impact of pension funds, both positive and negative, including on: climate and nature; social impacts such as wage inequality; and other workforce conditions. Pension schemes should be required to comply with reasonable requests for information relating to the performance of their investment functions, including the choice of investments they make and the use of shareholder voting rights. Having members on boards is a well-established practice and remains a legal requirement for many UK pension schemes. Master trusts that came into being under auto-enrolment are exempt, so should be required to draw on their large memberships to fill at least one third of their board seats, paying them like other board members.

iii. Ensure that expansion, consolidation and shifting of default models embed the need to put the interest of pension savers first, for example by designing new CDC schemes as not-for-profit structures, or examining not for profit options during consolidation processes.

iv. Ensure all schemes have diversity and inclusion strategies for their boards, record data on diversity and have regular training. The 2020 PLSA guide in 2020 showed that 83% of pension fund trustees are male, one third are over 60 years old and less than three per cent are under 30 years of age.[14] There is very weak data on ethnicity. Lack of diversity weakens decision making and governance. This would complement efforts to increase the number of member-nominated trustees.

v. Conduct a review of how to embed high standards of transparency and accountability across the whole system including asset managers, consultants, lawyers and other actors.

We believe this package of proposals is a proportionate response to the deep problems of the system, and offers hope that the UK pensions system can be reformed so that it truly works for pensioners and pension savers, the economy and the environment.

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Make My Money Matter

Make My Money Matter is a people-powered campaign founded by filmmaker and activist Richard Curtis. The campaign aims to give savers more voice and choice over their money so that their pension, investments, and bank align with their values and build a better world.

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