ShareAction»

Responsible Investment for a Better Future

The 2024 General Election will take place in the midst of unprecedented and converging sustainability crises: 2023 was Earth's hottest year in 174 years of climate data recording, biodiversity is in rapid decline globally, and the UK is one of the most nature-depleted countries in the world. Meanwhile, inequality is increasing and the cost of living, particularly for low-income households, has risen sharply due to increased prices for consumer essentials such as energy and food.

This year's election provides the next government an opportunity to demonstrate that the UK remains a global leader in tackling the enormous environmental and economic challenges we face. Climate change, nature loss and social inequality all require evidence-based, long-term policy making, and the next government must demonstrate a renewed commitment to ensure the UK enjoys a prosperous future.

The finance sector is a key lever to achieving successful and sustainable outcomes for people and planet. Financial institutions can help to support and drive the transition to a more sustainable world by investing in, lending to and insuring responsible businesses. Robust regulatory frameworks can help develop markets, build a resilient economy and ensure finance can flow away from polluting fossil fuels, towards the job-creating, zero carbon sectors of the future.

Too often, the rules that underpin investment activities act as a barrier to innovation. UK policy-makers have the chance to drive action at scale by setting a clear direction and high standards, promoting better regulation and increased transparency, and ensuring that companies and financial institutions are not acting contrary to the interests of the society in which they operate.

The next government will be in power at a critical time and must show ambitious leadership. In particular, it must re-examine the role of the finance sector in resolving deep-seated environmental and social challenges in ways that command strong public support and build long-term societal and economic resilience for the UK.

Our manifesto presents a package of measures that would have a significant positive impact in addressing climate change, biodiversity loss, declining health and rising inequality. These interventions build on previous existing policy initiatives and require little to no government expenditure. We urge the next government to be bold and take the necessary steps to help address these urgent crises.

Our proposals would drive a more responsible pensions sector, tackle greenwashing, improve company disclosures, and increase accountability and stewardship.

Our proposals would also boost green growth, reduce inequalities and help tackle urgent crises including climate change and biodiversity loss.

Fiduciary duty should be reformed to drive a more responsible pensions sector

The UK is the largest pensions market in Europe. UK pension funds hold over £3 trillion in assets under management but much of this money is invested in damaging activities such as fossil fuels and deforestation. Pensions funds could instead be a source of capital for clean energy and green technology and become a significant driver of green growth.

Recent research by ShareAction shows that a clear majority (73%) of those asked believe that environmental and social issues should be considered alongside profits.[1] Unfortunately the law still understands the purpose of pension investments to be solely financial, ignoring the relationship between the financial system and our wider world. This framework is no longer suitable for the challenges that investors and policymakers now face in dealing with existential challenges such as climate change and the biodiversity crisis.

The narrow focus on financial returns is contributing to savers' money not being invested responsibly. This is true both financially, as systemic risks from environmental and social issues are unlikely to be adequately addressed, and more broadly, by jeopardising savers' chances of retiring into a world that provides them with a good quality of life.

Fiduciary duties exist to ensure that those managing the money of others act in their best interests. However, despite some regulatory clarification of the concept of fiduciary duty in 2018, respondents to the recent DWP/HMT call for evidence stated that there remains a lack of clarity around how fiduciary duty interacts with sustainability and climate change considerations.[2]

The Financial Markets Law Committee (FMLC) recently published its long-awaited report on fiduciary duty.[3] The FMLC is clear in their assessment that sustainability factors can, and should, be considered under fiduciary duty. However, we have been here before; clarifications have a role to play but they haven't yet been able to move the dial in aligning pensions with the true long-term best interests of beneficiaries. What we need is an explicit redefinition of 'best interests' in law to reflect the non-financial determinants of pension savers' welfare. The government must therefore reform legislation to clearly define this responsibility in the letter of the law and ensure that trustees take real action to address sustainability risks and opportunities.

We propose that policymakers amend the law to include a clarified and expanded definition of beneficiaries' 'best interests'. This approach would retain trustee's core duties of loyalty, impartiality and prudence, whilst giving greater latitude to trustees to act on sustainability impacts and incorporate beneficiaries' views. This would also ensure that trustees fulfil their existing duties to consider sustainability-related financial risks and opportunities more comprehensively, by encouraging trustees to act on sustainability impacts that are likely to have systemic financial implications in the long-term.[4]

The next government should amend the law to include a clarified and expanded definition of savers' best interests, giving greater latitude to trustees to act on sustainability impacts

Pension savers should be protected from greenwashing

Pension savers should be confident that their money is being managed responsibly and that the financial services sector is working to grow and guard their money. Over 80% of UK adults want their money to do some good as well as provide a financial return[5] yet this is rarely reflected in the way people's savings are managed.[6]

In 2023 the Financial Conduct Authority (FCA) introduced new rules to tackle greenwashing and ensure that funds marketed as sustainable do as they claim and provide evidence to back up those claims. Unfortunately, those rules only apply to retail funds (i.e. funds marketed to individuals who are investing their own money) and so the potential for positive impact is limited by the comparatively small size of the UK retail market. The new rules do not apply to institutional investors (i.e. organisations such as pension schemes who invest on behalf of others).

UK pension schemes hold over £3 trillion in assets under management and have approximately 16 million members. Given the focus of the FCA regime on protecting consumers and the FCA's new Consumer Duty, we believe that the FCA should extend the scope of the new rules to cover pension schemes. By including pension schemes the new regime would have far more impact in helping accelerate the transition to net-zero whilst also providing UK savers with the reassurance that their savings are genuinely being invested in a sustainable way. The FCA should work with the Department for Work and Pensions and The Pensions Regulator to consider how pension products, particularly those used for automatic enrolment, could be incorporated into the regime.

New investment labels to tackle greenwashing and increase public trust in sustainable finance products should be expanded to cover pension savers

SDR should be mandatory and include social disclosures including health

The reporting landscape in the UK is incredibly fragmented. Currently, the primary source of ESG data is corporates making disclosures of sustainability-related information that is largely based on self-assessment with varying degrees of independent audits. There is a clear and urgent need for an integrated and streamlined reporting framework for mandatory sustainability-related corporate disclosures.

Mandating environmental disclosures is necessary but not sufficient. Social-related disclosures are also needed, including health disclosures. Poor health and health inequity continue to limit economic prosperity whilst interventions to improve health would boost long-term global economic growth.[7] Unfortunately, current data on companies' health-related impacts, practices, and relevant risks is often limited, incomplete, and poor quality. For example, many companies directly contribute to air pollutants but few companies currently report on key air pollutants or set publicly available policies for reducing their air pollution impact.

We are calling for UK policy makers to implement the Sustainability Disclosure Requirements (SDR) regime to create a clear, comprehensive and robust reporting landscape.[8] SDR would enhance transparency and accountability whilst addressing the challenge of greenwashing and being a catalyst for the adoption of more sustainable company practices. The current government had previously committed to the introduction of SDR but withdrew these plans in the lead up to the Queen's Speech in May 2022.

The next government should legislate for:

- **Mandatory sustainability-related corporate disclosures**
- **Mandatory social-related corporate disclosures which explicitly integrates health**

TNFD should be embedded in regulation

The financial materiality of the biodiversity crisis must be acknowledged. Over 50% of global gross domestic product (GDP) is 'moderately or highly dependent' on nature and ecosystem services.[9] The UK has a particular biodiversity challenge – the UK is one of the most nature-depleted countries in the world and more than 15% of all UK species are at risk of extinction.[10]

Whilst many UK companies are now beginning to take action on the climate crisis, their approaches to biodiversity loss are severely lacking in ambition and commitment. UK financial institutions are not doing enough to incorporate biodiversity in their investment decision making or in their stewardship activities.

The Taskforce on Nature-related Financial Disclosures (TNFD) is a framework enabling organisations to disclose their impacts and dependencies on nature. It has been designed to closely follow the structure of the TCFD (its climate predecessor) to allow for easy uptake. TCFD is a good example of a relatively successful approach to integrating a disclosure framework in financial regulation and there are many lessons from TCFD that can applied to TNFD.

The Environmental Audit Committee recently recommended that the Government phases in mandatory TNFD over the next three to five years. We agree and we think the next government should be even more ambitious given the scale of our biodiversity crisis and also the positive effect of the learning available from the implementation of TCFD.

- **The next government should introduce mandatory TNFD**
- **TNFD should be adopted more quickly than TCFD**

Ethnicity pay gap reporting should be made mandatory

UK poverty statistics show the stark and entrenched income inequalities faced by Black and ethnic minority communities across the UK, with many struggling to make ends meet during the current cost-of-living crisis. Long-term trends in poverty and inequality among these communities are being driven by persistent labour market inequalities including low wages, insecure work, and discrimination. Not only is this bad for those who suffer from it, it is bad for our economy – recent research indicates that improved racial equality could boost the UK economy by £24 billion per annum, equivalent to 1.3% of GDP.[11]

Mandatory ethnicity pay gap reporting by the UK's largest companies is a crucial first step among a set of wider policy measures necessary to identify and measure the scale of racial disparities in any organisation.[12] This would drives accountability, address persistent labour market inequalities and promote greater fairness in the workplace. Companies should report on employees' ethnicity pay gap, broken down into the most appropriate categories and quartile pay bands, in addition to the overall pay gap. Ethnicity pay gap reporting should become a key part of a company's diversity, equity and inclusion culture.

Companies can build on their experience of mandatory gender pay gap reporting and voluntary ethnicity pay gap reporting undertaken by 35 FTSE100 companies, amongst others. We have produced a toolkit[13] demonstrating that perceived barriers to mandatory ethnicity pay gap reporting can be overcome and that such reporting will help companies to identify and address disparities.

The next government should legislate for mandatory ethnicity pay gap reporting for employers with 250+ employees

Establish a stronger mandatory framework for stewardship standards

Stewardship is the responsible allocation, management and oversight of capital to create long-term value for clients and beneficiaries leading to sustainable benefits for the economy, the environment and society.[14] The primary regulatory mechanism which governs stewardship is the Financial Regulatory Council's Stewardship Code but the FCA, DWP, HMT and DWP are also responsible for regulations that affect stewardship.

ShareAction has conducted research on stewardship practices over many years and we know that the UK Stewardship Code has gone a long way to raising stewardship standards and expectations amongst its signatories.[15] However, its voluntary nature places an inherent limitation on its impact for the market as a whole. Furthermore, a number of Stewardship Code signatories do not routinely operate in accordance with the Code's principles.[16]

There is an urgent need for a more rigorous and enforceable stewardship regime, not least given expectations that institutional investors help facilitate a transition to low carbon prosperity through active stewardship of high carbon companies and companies exposed to climate-related financial risk.

We consider that the Stewardship Code should be strengthened in a number of areas, in particular in relation to escalation policies, activities and outcomes; collaborative engagement; the measurement and management of ESG impacts; and a greater recognition of "S" impacts including health.

As part of its Vote Reporting Group work the FCA is currently considering publishing a voluntary vote reporting template for industry. While this is welcome, the FCA should move ahead with more ambitious measures to require transparency from firms, specifically a mandatory voting disclosure regime. This would lead to more consistent reporting, enabling investors such pension schemes to understand how their shares have been voted on.

Such a regime should also include disclosure of voting rationale, to enable investors to understand the reasons behind asset managers' voting decisions. The FCA would play a key role in enforcing such a regime to provide firms with sufficient inventive to comply with the rules.

The regulation of audit, corporate reporting and governance also needs to be strengthened. In particular, the Financial Reporting Council (FRC) should be replaced by the Audit, Reporting and Governance Authority (ARGA). ARGA would be a new statutory regulator with tougher enforcement powers. The creation of ARGA was proposed in the Kingman Review in 2018 and the ARGA White Paper was published in 2021. There is broad stakeholder consensus that this reform is necessary to restore investor and public trust following the damaging collapses of several high-profile business including Carillion, BHS and Thomas Cook.[17] We understand that there is cross-party support for ARGA but that there have been a number of delays to the required legislation being tabled in Parliament.

- **The next government should drive a more rigorous and enforceable stewardship regime**
- **The next government should expedite the Audit Bill and replace the FRC with ARGA**

References

1 ShareAction (2023) "ShareAction challenges finance sector to adopt ambitious new definition of 'responsible investment'" https://shareaction.org/news/shareaction-challenges-finance-sector-to-adopt-ambitious-new-definition-of-responsible-investment

2 Department for Work & Pensions (2023) "Call for Evidence Response Government response to 'Pension trustee skills, capability and culture: a call for evidence'" https://assets.publishing.service.gov.uk/media/656601f6750074000d1ded51/govt-response-pension-trustee-skills-call-for-evidence.pd

3 Financial Markets Law Comittee (2024) "Pension Fund Trustees and Fiduciary Duties - Decision making in the context of Sustainability and the subject of Climate Change" https://fmlc.org/publications/paper-pension-fund-trustees-and-fiduciary-duties-decision-making-in-the-context-of-sustainability-and-the-subject-of-climate-change/

4 ShareAction (2023) "In All Our Best Interests: Reforming Fiduciary Duty for the 21st Century" https://cdn2.assets-servd.host/shareaction-api/production/resources/policies/In-All-Our-Best-Interests-fiduciary-duty.pdf

5 FCA (2022) "Sustainability Disclosure Requirements (SDR) and investment labels" https://www.fca.org.uk/publication/consultation/cp22-20.pdf

6 The Guardian (2023) "'Sustainable' pension funds accused of greenwashing over billions held in oil and gas firms" https://www.theguardian.com/business/2023/may/14/sustainable-pension-funds-accused-of-greenwashingover-billions-held-in-oil-and-gas-firms

7 McKinsey (2020) "Prioritizing health: A prescription for prosperity" https://www.mckinsey.com/industries/healthcare/our-insights/prioritizing-health-a-prescription-for-prosperity

8 ShareAction (2023) "The UK's Sustainability Disclosure Requirements: why policymakers should legislate for mandatory sustainability disclosures" https://shareaction.org/policies/the-uks-sustainability-disclosure-requirements-why-policymakers-should-legislate-for-mandatory-sustainability-disclosures

9 World Economic Forum (2020) "Half of world's GDP moderately or highly dependent on nature" https://www.weforum.org/press/2020/01/half-of-world-s-gdp-moderately-or-highly-dependent-on-nature-says-new-report/

10 House of Commons Environmental Audit Committee Report (2021) "Biodiversity in the UK: bloom or bust?" https://publications.parliament.uk/pa/cm5802/cmselect/cmenvaud/136/136-report.html

11 DBT and BEIS Independent report (2017) "Race in the workplace: The McGregor-Smith Review" https://www.gov.uk/government/publications/race-in-the-workplace-the-mcgregor-smith-review

12 ShareAction (2023) "Ethnicity pay gap reporting: A guide for parliamentarians" https://cdn2.assets-servd.host/shareaction-api/production/resources/reports/EPG-MP-briefing.pdf

13 ShareAction (2023) "Ethnicity Pay Gap Reporting: An investor briefing and toolkit" https://shareaction.org/reports/ethnicity-pay-gap-toolkit

14 Financial Reporting Council (2020) "The UK Stewardship Code 2020" https://media.frc.org.uk/documents/The_UK_Stewardship_Code_2020.pdf

15 ShareAction (2023) "Point of No Returns 2023 Part II: Stewardship and Governance" https://cdn2.assets-servd.host/shareaction-api/production/resources/reports/PONR-PT2_2023-final.pdf

16 The Independent (2023) "Hold firms signed up to sustainability code to higher standards, watchdog urged" https://www.independent.co.uk/business/hold-firms-signed-up-to-sustainability-code-to-higher-standards-watchdog-urged-b2402655.html

17 Department for Business, Energy & Industrial Strategy (2021) "Restoring trust in audit and corporate governance: proposals on reforms" https://www.gov.uk/government/consultations/restoring-trust-in-audit-and-corporate-governance-proposals-on-reforms

Runway East
2 Whitechapel Road
London
E1 1EW

enquiries@shareaction.org
+44 (0)20 7403 7800

UK registered charity number: 1117244

EU Transparency Register number: 75791956264-20

Belgian organisation number: Fairshare Educational Foundation 0672.921.563

ShareAction»

ShareAction is a registered charity working globally to define the highest standards for responsible investment and to drive change until these standards are adopted worldwide. Our vision is a world where the financial system serves our planet and its people.