Fair, Green Pensions For All

Policy recommendations to support decent pensions for all, and a sustainable, thriving economy

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We represent a coalition of trade unions and civil society organisations campaigning for decent living standards in retirement, responsible investment, financial stability and a sustainable economy.

The UK's pension system is confronting multiple crises. Almost half of current workers are not on track to achieve even a "moderate" retirement living standard.[1] Pension funds invest at alarming rates into fossil fuels and deforestation, destroying the climate that savers have an existential stake in protecting.[2] Investments in long-term productive infrastructure have been low compared to peers and sometimes use vehicles with a track record for high fees and short-termist, irresponsible practices.[3] Meanwhile, the liability-driven investment (LDI) crisis of October 2022 demonstrated the threat to financial stability the current regime can pose.

Pensions policy reform can turn this around, creating a win-win system where patient investment in a healthy, and sustainable economy is coupled with financially secure and dignified retirement for all. To do this, policy makers will need to focus on three key issues:

A. Ensuring adequate pensions for all;
B. Fairly sharing risk within occupational pension schemes; and
C. Ensuring responsible pension fund investment which supports the just, green transition.

We make key specific recommendations for reform under each issue.

1. Common Wealth, "Undefined Benefit: Fixing the UK Pensions System", 2023.
2. Make My Money Matter, "Fossil Fuels in UK Pensions: An analysis of Fossil Fuel exposure in UK Pension Funds", 2023.
3. Brett Christophers, "The dangers of asset managers when it comes to long-term infrastructure", *The Financial Times*, 17/04/23. For more extensive detail see Christophers, *Our Lives in Their Portfolios: Why Asset Managers Own The World*, Verso: 2023.

A: Adequate Pensions for All

The current pension system means that most people are saving far too little to expect adequate income in retirement. The state pension remains low compared to European peers, and below minimum acceptable levels of income. Too many, including a disproportionate number of women, are unable to access the full state pension because of its link to National Insurance Contributions (NICs, which can be impossible to meet for those with irregular contribution histories). Widespread evidence shows that the majority of people are not saving enough in occupational pensions, with recommendations for minimum necessary savings rates ranging from 12-15% of income, up from the current 8% minimum. The link between contributions and salaries means that the occupational pension system reproduces and amplifies existing labour market inequalities, meaning that women, people of colour, disabled people and other groups will fare worst in retirement.

The following recommendations — which are not intended to change unfunded public service pension schemes — will be key to ensuring that everyone can retire with an adequate pension, and would also significantly boost saving rates, which would have significant macro-economic benefits explored later.

1. **Continue to improve the state pension.**
   The “triple lock” must be retained so that the state pension can, over time, rise to an adequate level of minimum income for all. The number of years’ National Insurance Contributions (NICs) required for full access to the state pension should be reduced, or alternative criteria for state pension qualification should be considered. Tax reliefs on pensions could be reformed to make them more progressive.

2. **Significantly boost occupational saving.**
   In the case of defined contribution (DC) schemes, we support a significant increase in the minimum levels of employer contribution, while noting that smaller employers may need support to phase this in. For defined benefit (DB) schemes, surpluses should only be used to benefit pensions savers.

3. **Ensure more people are saving.**
   An equivalent to auto-enrolment needs to be designed for those who are left behind by the current system, in particular the self-employed and those unable to work or who take extended time out of the labour force, for example because of caring responsibilities.

4. **Ensure that everyone can save enough.**
Already agreed changes to automatic enrolment — removing the age limit and the lower earnings limit — should be enacted. Ways of supporting those on low incomes, or with lower ability to save due to, for example, very low or irregular incomes, should be developed and implemented. These could include mandating minimum absolute levels of employer contributions set at adequate levels, or allowing those earning the Living Wage or less to receive adequate employer contributions without employee contributions.

B: Fair Risk-sharing

Any pension system has to deal with significant risks, including that individuals don't know how long they will live in retirement (longevity risk) or what the value of their savings will be when they do retire (investment risk). This makes pensions an intrinsically collective endeavour, as these risks can be significantly reduced for all by sharing them appropriately. However, the current system — with DC funds as the default model — does exactly the opposite, by asking individuals to shoulder investment and longevity risks. The stakes are particularly high for those with small pension pots, which is currently the majority of the population. The system also places very high financial literacy demands on everyone, which is neither fair nor rational.

Thankfully, reform based on existing models could transform this picture. We therefore recommend:

1. **Encouraging the uptake of Collective DC (CDC) schemes rather than individual DC schemes.**
Other countries have helped share longevity and investment risks through CDC schemes which are now being introduced into the UK. This could be done in a way that also ensures a more progressive model, including in combination with the recommendations in section A. The promotion of not-for-profit master trusts would help ensure that the new system focused on the interests of pension savers.

2. **Supporting DB schemes to grow.**
Keeping DB schemes open to new entrants would help balance active against retired members. Regulations for DB schemes should be reviewed to support their growth and ensure they are able to focus on longer-term investment horizons and reducing risks. This could include examining balance sheet and collateral valuation, short-term liquidity constraints and the use of leverage and derivatives. Risks associated with the current trend for insurance companies to buy out DB schemes should be examined.

3. **Ensuring member representation.**
   Given pensions are a collective endeavour, it is only fair that members and their views are represented in decision making. The governance arrangement of pension schemes should be reformed to ensure that those saving into pensions always have a strong voice and representation in decision-making contexts.

Alongside the increase in savings rates recommended in section A, the above reforms would reorient the whole system towards a greater focus on patient, longer-term investment which would benefit pension savers, the economy and the environment.

C: Responsible Investment for the Just Green Transition

Current environmental trends threaten our economy and even our entire civilisation. The just, green transition to an economy that keeps the planet within safe climate limits and prevents the dangerous destruction of nature is therefore of paramount importance for wellbeing in retirement. Pension funds, as major investments have a key role to play in supporting this transition, but currently continue to invest heavily in fossil fuels and nature destruction. Investment also has major social impacts which need to be better taken into account. We therefore recommend:

1. **Greening the system.**
   Regulatory power should be deployed to ensure that investments in ecologically destructive activities are penalised, while pension portfolios are more actively brought into line with national green transformation priorities. At a minimum, all pension funds should be required to have science-based 1.50C aligned transition plans. To go further, we argue that it is justifiable to disincentivise the holding of non-Paris-aligned assets in pension portfolios. Transparency — on portfolio allocation, climate risk modelling and investment consulting, and ESG ratings — and accountable governance are preconditions to all of this. The views and preferences of members must be properly represented.

2. **Giving regulators the power to act.**
   Existing regulations need stronger enforcement, and regulators (including the FCA, TPR and PRA) should be properly empowered with statutory mandates to work proactively on the greening on the pensions system and the financial services sector more broadly.

3. **Reforming fiduciary duty.**
   There can be no meaningful interpretation of fiduciary responsibility that still

permits the mobilisation of people's savings towards the accelerated destruction of the planet. The definition of "fiduciary responsibility" should be reformed accordingly, and it should also reflect the need for pension funds to consider the social impacts of their investments — including, for example, mandatory due diligence with regard to deforestation risk — particularly given their capital allocation across the economy effects both their own beneficiaries and society more broadly.

We recognise that pension fund investment will function best when working in tandem with a long-term green industrial strategy. We believe the above package of reforms would help provide a significant increase in longer term investment to support this strategy. However, we recognise that there will be tensions, for example between decent pension fund returns and the provision of high-quality, infrastructure at a low cost to users: costly mistakes such as the previous Public Finance Initiative (PFI) policy must be avoided.

Now Is the Time for Action

The need to reform the pension system enjoys a level of consensus that must be nurtured. That is why we have gathered a wide range of organisations together to recommend the above sensible and achievable reforms. It is also why we support proposals to establish a permanent, independent Pensions Commission, with representatives from employers, trade unions and civil society organisations to review the system and make recommendations for improvement.

The coming few years present a major opportunity to fix the system to deliver decent retirement income for all, while boosting investment to green and strengthen the economy. This opportunity must not be missed.