Phoenix

Unlocking Investment in Climate Solutions

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thephoenixgroup.com

Created in partnership with

Make My Money Matter

Phoenix

Foreword

Andy Briggs, CEO of Phoenix Group

When we published our Net Zero Transition Plan, we set out the actions we are taking to become net zero by 2050 across our investment portfolio, operations and supply chain. Our customers are at the heart of our plan and everything we do has their best interests at its core. By taking the right actions to decarbonise, we believe that we can manage the risks and maximise the opportunities of climate change on their behalf. And with 12 million customers and close to £0.3 trillion assets under administration, our scale means we can make a real difference.

Our investment portfolio accounts for around 99% of our overall carbon footprint and is therefore the biggest focus of our net zero transition. It is also the most challenging part because, despite the actions we are taking ourselves (such as launching our stewardship engagement strategy and preparing to roll out bespoke decarbonising strategies to our listed assets), we ultimately rely on action from others such as governments and high-emitting sectors to achieve our goals. That's why one of the central pillars of our transition plan is using our scale and voice to drive wider system change to help establish the right policy, regulatory and market conditions to achieve net zero. This report is a fantastic example of this in practice.

The report's focus – scaling up investment in climate solutions – is one of the key potential levers that could help us achieve net zero. Doing so on the right terms would enable our customers to benefit from growth opportunities arising from the transition to net zero, as well as contribute directly to real economy decarbonisation. That's why last year we set our aspiration to invest up to £40 billion in sustainable and productive finance – but only if doing so is in our customers' best interests to and throughout retirement.

At present though, we, like many of our peers, are facing a range of barriers to scaling up our investment in climate solutions. This report highlights the huge potential opportunity for the UK pension industry to invest more and sets out some of the key actions that we believe could help to enable our investments in a way that aligns with customers' interests. Our hope is that this report catalyses further debate, collaboration and innovation that will ultimately lead to action by government, regulators and industry – because we all have a part to play.

Our approach to developing this report has been highly collaborative – not just with Make My Money Matter and Boston Consulting Group, but also with our peers, industry bodies, think tanks, government and regulators. We have welcomed their contributions, which have undoubtedly made it a better end-product. We hope that our approach means the report represents some level of consensus on the key opportunities that could help unlock greater investment in climate solutions. Our collaborative approach also reflects, we hope, a broad desire to make key changes happen.

Andy Briggs, Group CEO

For us, this report is a platform for further thought leadership, engagement and, crucially, collaboration that will help to drive the necessary wider system change. I look forward to working with you as we continue on our journey towards achieving net zero and simultaneously helping our customers secure a life of possibilities.

Make My Money Matter

Foreword

Tony Burdon, CEO of Make My Money Matter

Tony Burdon, CEO

Make My Money Matter is pleased to have worked with Phoenix Group, BCG and allies across the pensions industry on this important and timely report. As we near the end of 2023, the situation couldn't be clearer – we're facing a global climate and nature emergency, and we all must do our part to address it.

And for us, that starts with our money. The UK pension industry can play a critical role in combatting the worst effects of climate change by transitioning from fossil fuel investments, financing solutions to the climate emergency and tackling deforestation. In doing so they can support their members into retirement, protect customer returns and help build a world worth retiring into.

The good news is that many changes are already underway. Public awareness is increasing, corporate demand is growing, and pension schemes are beginning to invest in cleaner, greener businesses, from wind farms to solar panels, from lithium batteries to vertical farming. Sustainable investments have potential to be profitable for savers, beneficial for our economy, and popular too. As recent analysis from Make My Money Matter shows, 12 million UK pension holders want their scheme to invest more in climate solutions.

But the reality is we're nowhere near maximising the potential of our pensions for people or for planet. That's why this new report is so important, as it outlines how, with increased ambition and collaboration – and supported by the right policy and regulatory reforms – the UK pension industry can quadruple its investments in climate solutions. By taking these steps, this report's analysis shows how we can mobilise a staggering £1 trillion by 2035 to help tackle the climate emergency, both at home and abroad.

For this money to be unleashed however, we need greater urgency and more action – from the industry, from regulators and from government. That's why Make My Money Matter will be working with partners throughout 2024 to help unlock this £1 trillion of investment.

To do this, we will engage the public on the enormous power of pensions. We will work with industry to help them deliver on the recommendations of this paper – both in the UK and internationally in Emerging Markets and Developing Economies. And we will collaborate on the policy and regulatory reforms identified to unblock the barriers preventing the pension industry from going further and faster. In doing so, we hope to help build a pension system fit for the challenges of our generation – one that does not just turn on the taps, but also keeps the money flowing into the future.

And if we can do this, the potential rewards for people, planet and our pensions can be significant. In the UK, we can make sure our money is greening our economy, addressing social challenges and creating hundreds of thousands of jobs in greener industries. Internationally, there are huge opportunities for our pensions to support developing countries as they finance their transition to cleaner economies, driving growth and greener jobs.

And in the end, we believe savers can be the real winners. Millions of people across the UK contributing to pensions each month - and relying on them for future security - will not only be building a more healthy, equitable planet to retire into, but also investing in the sustainable industries of tomorrow.

We know this will be challenging, but with positive engagement from many in the pensions industry – and growing public and collective demand for "pensions to be proud of" – we are optimistic that we can put pensions at the heart of a global climate fightback and take advantage of the greatest commercial opportunity of a generation.

We hope this powerful report helps put our money to work for people, planet and a prosperous retirement, and we look forward to collaborating with partners in industry to help make this happen. Because after all, what's the point of a pension in a world on fire?

Contents

Foreword: Andy Briggs, CEO of Phoenix Group 2

Foreword: Tony Burdon, CEO of Make My Money Matter 3

Introduction 5

Executive Summary 7

Chapter 1 **The transition to net zero requires a global effort** 11

Four ways that the global pension industry can support the transition to net zero 13

Chapter 2 **The UK requires significant investment in climate solutions by 2035** 14

UK net zero ambition 15

The UK pension industry is growing and well-positioned to invest in climate solutions 17

Understanding the barriers the UK pension industry faces to increasing investments in climate solutions 20

Chapter 3 **Strategies for unlocking investment in climate solutions** 22

Seven strategies to overcome the barriers 23

Four high-priority strategies in the short-term 26

Implementing the strategies could help enable the UK pension industry to invest £0.8-1.2 trillion in UK climate solutions between now and 2035 27

The UK has made progress on some of these strategies 29

How the UK pension industry can immediately push forward 30

Investing beyond the UK 32

Chapter 4 **Call to Action** 34

Appendix 37

Endnotes 44

About 46

The role of the UK pension industry in financing the transition to net zero

As providers of pension and savings solutions, our primary focus is to deliver good financial outcomes for our members and customers. In doing so, we believe that by navigating a transition to a net zero future well, we can improve outcomes through superior returns and effective risk management. Delivering net zero by 2050 remains a huge challenge and will require a step-change in collective action and investment. So far, more than 70 countries, including the UK, have set net zero targets, along with thousands of businesses, financial and educational institutions.

However, overall progress towards net zero remains slow. Delivering net zero requires a fundamental transition of the whole economy. No single business, sector, government or stakeholder group can affect the necessary transformation alone. Every business needs to act; and every business is dependent on action from others.

Within the UK, we believe that the pension industry – which comprises of pension funds and insurance companies – has the potential to play a key role in accelerating the UK's progress towards net zero. Our industry's significant scale (£3.7 trillion assets in 2022) and long-term investment objectives make us well-positioned to invest in climate solutions. This potential, however, needs to be carefully and strategically unlocked. What are the barriers holding us back from investing further in climate solutions, and what can we do to overcome them?

To address these questions, this report highlights:

- **The significant role that UK pension industry could play in financing the investments the UK needs to be on track to achieve net zero by 2050**
- **The policy and regulatory barriers currently preventing us from fully playing our role**
- **The strategies that government bodies, industry regulators and the pension industry can follow to mitigate these barriers**

By taking the right actions to decarbonise, we can help pension savers grow their investments and protect them against the financially material risks of climate change. It is our fiduciary duty to always make decisions in the best interest of our customers, and any steps we take to decarbonise needs to make financial sense for our customers. Pension savers are increasingly aware of the impact of their pensions, and many want to see them invested in sustainability efforts to combat climate change.

This report is not meant to provide a detailed blueprint for action. Rather, it is intended to kick-start a necessary conversation on two questions. First, how we can collectively address the barriers to investing in climate solutions? Second, what concrete strategies can enable deeper investment from our industry in climate solutions at scale and in a way that builds upon the foundations set by the government, regulators and pension players?

Although this report focuses on climate change and climate solutions to help achieve net zero, we recognise that climate change is only one of the five drivers of changes in our natural environment alongside land, freshwater and ocean use change, resource use, pollution and invasive alien species.[1] Over time, managing nature risk and opportunity is expected to become increasingly integrated with efforts to combat climate change.

The authors would like to thank Boston Consulting Group for contributing to the development of this report.

Acknowledgements

Phoenix and Make My Money Matter would like to thank all those listed below for their contribution and engagement in the production of this report. Whilst all share an aspiration for greater investment in climate solutions by the pension industry, their involvement does not necessarily signify endorsement of the entire report and its recommendations.

- **Aegon UK**
- **Aon**
- **Association of British Insurers (ABI)**
- **Aviva**
- **Border to Coast**
- **E3G**
- **Environment Agency Pension Fund**
- **Glasgow Financial Alliance for Net Zero (GFANZ)**
- **Green Finance Institute (GFI)**
- **Impact Investing institute**
- **Legal and General Investment Management (LGIM)**
- **Nest**
- **Pension and Lifetime Savings Association (PLSA)**
- **Principles for Responsible Investment (PRI)**
- **Royal London**
- **Scottish Widows**
- **The Pensions Regulator (TPR)**
- **UK Sustainable Investment and Finance Association (UKSIF)**

Executive Summary

The UK pension industry could invest up to £1.2 trillion in climate solutions by 2035

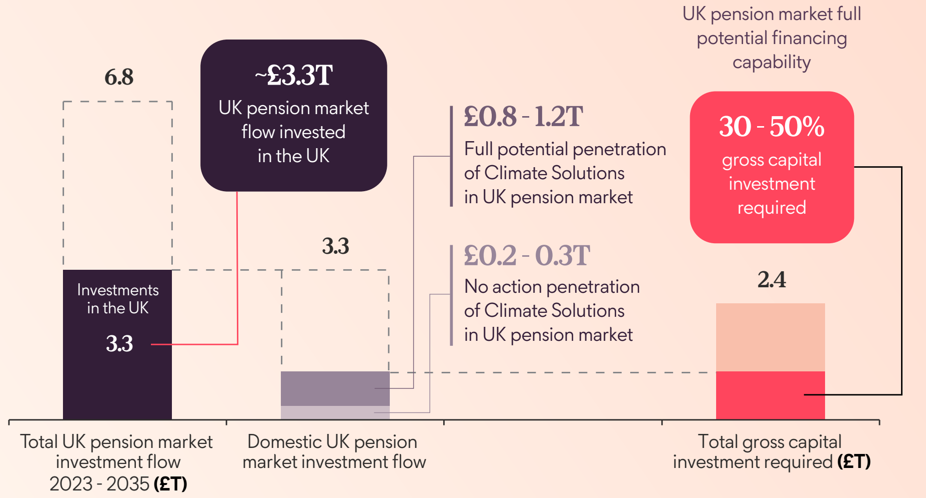
The UK requires significant capital investment in climate solutions by 2035
Achieving net zero by 2050 remains a huge challenge. To remain on track, the next decade is crucial and will require massive investment, with $40-60 trillion gross capital investment in climate solutions needed globally between now and 2035,[2] of which £2.4 trillion will be needed in the UK.

The UK pension industry is currently on track to deliver 10-15% of this
The UK pension industry is on track to invest £6.8 trillion in total between now and 2035, of which approximately half (£3.3 trillion) will be invested domestically. However, we estimate that currently only 4% (£0.1 trillion) of our industry's assets are currently invested in climate solutions. If current trends continue, our industry will invest £0.2-0.3 trillion in UK climate solutions between now and 2035. This represents c.10-15% of the total UK investment required.

Greater investment is currently limited by a scarcity of scalable opportunities and regulatory constraints
We know there is a genuine appetite across the UK pension industry to scale up investment in climate solutions – and many companies have set public aspirations to do so. However, many are currently struggling to match their ambition with action due to a range of policy and regulatory barriers which affect both the demand for finance and the supply of finance. These barriers limit our ability to invest in ways that deliver customer value and, crucially, align with fiduciary duty.

Overcoming barriers could help enable the UK pension industry to finance up to £1.2 trillion of capital investment in UK climate solutions, or up to 50% of the total requirement
If these barriers can be overcome, we believe the UK pension industry has the potential to quadruple its investment in climate solutions by 2035 from £0.2-0.3 trillion to £0.8-1.2 trillion (Figure 1) in a way that delivers value to customers. There are two key reasons why climate solutions can be attractive to our industry. First, investment opportunities in climate solutions are often in 'alternative' assets, which can potentially deliver more attractive yields to customers than 'traditional' assets classes such as listed equity and debt. Second, investing in climate solutions contributes to our long-term prudential strategy of protecting customers from the financial, economic and social risks of climate change. If we are able to invest £0.8-1.2 trillion by 2035, this would represent approximately 30-50% of the total gross capital investment needed for the UK to remain on track for net zero by 2050.

Figure 1 | Potential impact of implementing strategies to scale up investment



Note: Totals may not add up due to rounding
Sources: Investment Association – Investment Management in the UK 2022-2023 report; UK Govt; CBI; Eurostat; Goldman Sachs; Bloomberg; FTSE Russell; PitchBook; IEA; Preqin; Refinitiv; Pension Providers Interviews

We have identified seven strategies that can help mitigate the barriers to investment

Three of the strategies address the scarcity of opportunities ('demand for finance' barrier) and four address the regulatory constraints ('supply of finance' barrier). All seven build on existing initiatives and good progress has already been made against all of them. Despite this progress, much more still needs to be done to unlock our industry's full investment potential in climate solutions.

Strategies to address barriers that impede the 'demand for finance' for climate solutions:

1. A National Transition Plan:
The UK should develop an economy-wide National Transition Plan, defining a range of sector-specific strategies, roadmaps and policy instruments to support investment in climate solutions.

2. Policy intervention:
To make the UK attractive to investors, long-term policy certainty and incentives are key. Policy intervention aimed at reducing volatility of returns of climate solutions or abating costs for early-stage technology providers are central to this.

3. Scaling opportunities:
Initiatives that accelerate the go-to-market of new technologies, aggregate fragmented opportunities and provide a consistent planning regime at national level will all help to scale up the supply of climate solutions for investment across the UK.

Strategies to address barriers that limit 'supply of finance' in climate solutions:

4. Provide clarity on considering climate impact as part of fiduciary duties:
Fiduciary duties can be inconsistently interpreted across our industry. Providing clarity on how to consider climate risk and its effect of investments in a long-term prudential strategy will help our industry integrate the net zero transition into investment decisions and engage investee companies.

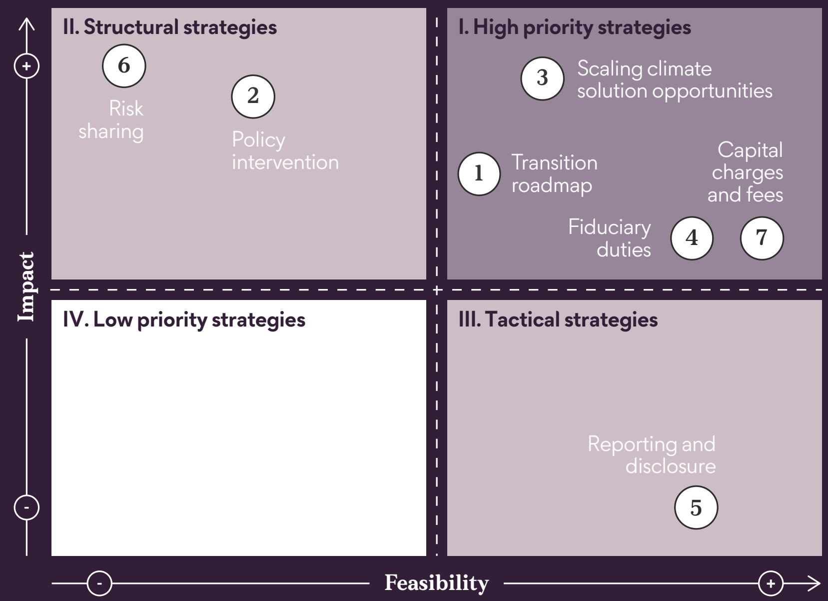
5. Reporting and disclosure requirements:
Requirements aimed at improving reporting transparency and standardisation of investment in climate solutions will provide greater clarity for investors and consumers in assessing climate risk.

6. Risk sharing:
Risk-sharing mechanisms between investors and government (central and local) can be effective ways of 'crowding in' private finance by altering the risk-return profile of investments to make them more attractive to long term investors.

7. Capital charges and fees:
Accelerating ongoing regulatory consultations – with the expectation that the capital freed up for investment would be targeted at productive and sustainable finance, including climate solutions – would make investment in climate solutions more appealing for our industry. Additionally, the government could consider exempting fees related to investing in climate solutions from the DC regulatory charge cap.

Based on an assessment of the seven strategies' potential impact and feasibility for implementation (Figure 2), we have positioned them into three quadrants: high priority strategies that require prompt action, structural strategies that could deliver longer-term impact, and tactical strategies. We recommend four high priority strategies to focus on in the short-term.

Figure 2 | Prioritisation of strategies



The UK pension industry can still do more, even in the absence of policy and regulatory change

While our industry is heavily dependent on supportive policy, regulation and industry standards to unlock our full potential to invest in climate solutions, there are nevertheless actions we all can take in the absence of policy and regulatory change. We have grouped these actions into three themes:

Do the basics right

- Define clear net zero targets and timelines within existing frameworks
- Establish governance measures that provide accountability for transition plans
- Integrate climate considerations across investment processes and mandates
- Upskill across the industry on climate opportunities and risks
- Align disclosures across transition plans and sustainability reporting with best practice

Innovate within the industry

- Work to improve climate scenarios and modelling tools
- Engage with beneficiaries to educate them on 'value for money'
- Develop new green investment and insurance products
- Develop new business models that can unlock transformation at scale

Advocate for broader system change

- Engage directly with government and regulators to inform the debate on the net zero transition and lobby for the strategies outlined in this report to be taken forward

Underpinning principles

Everything in customers' best interests
By taking the right actions to decarbonise, we pension companies can help our customers manage their investment risks as part of a long-term prudential strategy, as well as seize investment opportunities in climate solutions with attractive risk-adjusted returns on their behalf. We are not calling for investing in climate solutions at the expense of our customers' interests. It is the industry's fiduciary duty to always make decisions in the best interest of our customers, and any steps we take to decarbonise need to make sense for our customers financially as they save towards retirement.

We believe that acting on the recommendations in this report will help make more investments in climate solutions viable to the pension industry, given that we operate as long-term investors who make decisions on behalf of our customers.

Just Transition
When investing in climate solutions, it is fundamental to ensure a just transition to net zero. This means striving to minimise the potential negative side-effects of a net zero transition on workers and vulnerable communities and maximising the opportunities arising from creating decent work and ensuring equitable access and affordability for everyone.

Looking beyond the UK

The UK pension industry is expected to invest some £3.5 trillion internationally between now and 2035, of which £2.2 trillion will be in listed equity, £1.0 trillion in sovereign and corporate debt and £0.2 trillion in private debt, private equity and real estate.

While this investment presents a massive opportunity for international growth, developing nations rarely reap the benefits. For instance, within listed equity, only 25% is invested in emerging markets and developing economies (EMDEs). When we examine climate mitigation finance in particular, up to 80% is concentrated in Europe, North America and China. This funding gap is caused by a number of barriers to potential investment, including the financial and risk-return profile impact of foreign exchange risk and additional costs for deal closing.

Some of the strategies proposed to unlock investment in the UK could also apply towards EMDEs. However additional collaboration is needed with local governments, development banks and the private sector to develop finance instruments tailored to EMDEs.

Government, regulators and industry all need to act now – and we at Phoenix Group we are committed to playing our part

Action is needed now

This report is intended to shine a light on the huge opportunity for the UK pension industry to scale up our investment in climate solutions in a way that delivers value to our customers. In doing so, we hope to catalyse further debate, collaboration and innovation that is required to make it happen. Ultimately, though, this report needs to translate into action. While our report does not provide a detailed roadmap for action, Figure 3 summarises the key priorities for government, regulators and the pension industry where action is most needed – and most achievable – over the next 12 months.

Doing so could deliver huge benefit

By acting on the recommendations in this report, government, regulators and industry will help the UK pension industry lend our full weight towards investing in climate solutions. Doing so will not only help to tackle climate change, but also deliver wider economic and social benefits. By investing in the right way, we will help deliver a just transition for all and help our customers grow their investments and secure a life of possibilities.

Figure 3 | How to get started

Government & Local authorities

Transition plan

- Develop **UK climate transition plan** with sector-specific strategies and clear roadmaps

Scaling climate solution opportunities

- Outline a **consistent planning and permitting regime** to prioritise and to accelerate climate solution infrastructure build
- Build local hubs that **aggregate demand and provide expertise** (e.g., Local Net Zero Hubs, Net Zero Go platform)

Industry Regulators & associations

Fiduciary duties

- Provide clarity on considering climate impact as part of **fiduciary duties**

Capital charges and fees

- Deliver **matching adjustment** reform (Solvency UK)
- Consider **exemption of climate solutions fees** from DC charge cap

UK pensions

Innovation

- Develop **new green products and insurance products**
- Adopt best in class **climate financial models**
- Collaborate with peers and public funding bodies to **develop new business models**

Doing the basics right

- Articulate **a clear strategy to grow investments** in climate solutions
- Upskill **across the industry** on climate opportunities and risks
- Use **stewardship** to support achievement of net zero targets

At Phoenix Group, we are committed to playing our part

At Phoenix Group, we plan to use this report as a platform for the next phase of our work to drive wider system change. We will do this through a combination of thought leadership, engagement and collaboration, and look forward to continuing our positive engagement with government, regulators and industry to make this happen.

Chapter 1

The transition to net zero requires a global effort

The net zero transition requires a huge increase in investments in climate solutions around the world. The global pension industry can play a crucial role in supporting the transition, in particular by investing in climate solutions at scale, but needs to do so in a way that delivers value to its customers.

The transition to net zero requires a global effort

The scientific consensus is clear: the Earth's temperature must not exceed 1.5°C above preindustrial temperature levels to avoid catastrophic disruptions.[3] We know we need to reach net zero carbon emissions by 2050, and to do so we must reduce global emissions by 60% by 2035.[4] This will require a major increase in investments in climate solutions.

We define climate solutions as economic activities that contribute substantially to climate change mitigation or adaptation.[5] We need climate solutions that will avoid or remove carbon emissions, such as renewable energy, electric vehicles, sustainable aviation fuel and carbon capture technology. Our definition is consistent with widely accepted frameworks, such as the Net Zero Asset Owner Alliance (NZAOA)'s:[6]

> **"Climate solutions are economic activities that contribute substantially to climate change mitigation (including transition enabling) and adaptation. These are solutions that reduce greenhouse gases by avoiding emissions and/or by sequestering carbon dioxide already in the atmosphere, or contribute to enhancing adaptive capacity, strengthen resilience and reduce vulnerability to climate change. Economic activities making a substantial contribution to the climate change mitigation or adaptation must be assessed to ensure they do not cause significant harm to all remaining environmental or social objectives"**

60%
reduction in emissions by 2035 to keep net zero track

$40 - 60trn
gross capital investment between now and 2035

However, many climate solutions are still in early stages of development or have not fully scaled. In order to enable the development, implementation and scaling of climate solutions, we estimate that between now and 2035, we will need $40-60 trillion in gross capital investment globally.[7] We define such investment in two ways. First, direct investment in climate technology through private debt, private equity and targeted corporate and sovereign debt. Second, indirect investments in best-in-class listed equities according to environmental, social and governance (ESG) metrics. Direct investment has greater impact as it is directly linked to the financing of climate solutions. Mobilising this level of finance is a huge challenge that will require close collaboration across national governments and among governmental bodies, regulators and investors.

Four ways that the global pension industry can support the transition to net zero

We believe that the global pension industry can play a significant role by providing needed investment for climate solutions and, more broadly, accelerating global progress to net zero by 2050.

1. Invest

Most obviously, our global industry could help finance a transition to net zero by investing in climate solutions. We operate on long-term time horizons and with sizable assets; we are therefore well-positioned to invest in climate solutions at scale. Dozens of pension funds and insurance companies, collectively managing over $9.5 trillion in assets, have already joined the Net Zero Asset Owner Alliance (NZAOA). They have committed to reducing investments from high-carbon emitters and to supporting climate solutions that enable net zero emissions by 2050.[8] Additionally, over 400 asset owners and managers, collectively managing over $65 trillion, are part of the Institutional Investors Group on Climate Change (IIGCC). IIGCC provides policies, initiatives and programmes that support investors in generating returns for clients and beneficiaries and in including climate considerations in their portfolios.[9] Some IIGCC members have also joined the Paris Aligned Asset Owner (PAAO) group, which published in 2021 a Net Zero Investment Framework—the most implemented net zero methodology for investors and all financial institutions within the Glasgow Financial Alliance for Net Zero (GFANZ).

2. Advocate

Pension funds and insurance companies could also advocate for improved reporting standards, increased transparency, better ESG practices, as well as higher quality financial instruments for climate solutions. Already, all 200+ members of the Association of British Insurers (ABI) have recommended to the UK government that Taskforce on Climate-related Financial Disclosures (TCFD) reporting should be mandatory for all companies by 2025.[10]

3. Set the pace

Our industry could encourage businesses, customers and savers to make more sustainable choices in an informed and educated manner in line with their financial interests. We are also well-positioned to influence the activities of companies in which we invest through active stewardship. As an example, signatories of Principles for Responsible Investment (PRI) have committed to actively incorporate ESG issues into their ownership policies and practices,[11] such as by filing shareholder resolutions consistent with long-term ESG considerations.

4. Insure

The global insurance industry could offer insurance products and services that de-risk investment in climate solutions (e.g., energy efficiency infrastructure, low- or zero-emissions transportation). Groups like Allianz are amongst those that have recently disclosed their net zero strategy, indicating how they will support a net zero transition with insurance products and solutions, and their accountability to customers and markets.[12]

Now that we have established the global setting and challenge, we turn to the domestic context for the UK.

Just Transition

It is fundamental to ensure a Just Transition, which means striving to minimise the potential negative side-effects of a net zero transition on workers and vulnerable communities, as well as maximising the opportunities of creating decent jobs and ensuring equitable access and affordability for everyone. [1] COP26 identified the Just Transition as a critical enabling factor in the phase-out of fossil fuels and the scaling of renewable energy and other climate solutions. In the UK, the City of London launched a Just Transition Finance Challenge in July 2022 at its Finance For Impact Summit.[2] Fortunately, climate solutions are not zero-sum endeavours. Three critical drivers of a Just Transition are summarised by the Impact Investment Institute below:[3]

1. Advance climate and environmental action (e.g. reducing and removing GHG emissions).
2. Improve socio-economic distribution and equity (e.g. promoting inclusive opportunities for decent jobs).
3. Increase community voices (e.g. engage with and listen to affected communities that are often excluded and marginalised).

Chapter 2

The UK requires significant capital investment in climate solutions by 2035

The UK needs to invest £2.4 trillion in climate solutions by 2035 to remain on track for net zero by 2050. This presents a unique opportunity for the pension industry, which is growing and well suited to investing in climate solutions. However, its ability to do so in a way that delivers value to customers is currently hindered by barriers affecting both the supply of finance and demand for finance.

The UK requires significant capital investment in climate solutions by 2035

UK net zero ambition

The UK's Sixth Carbon Budget estimates that £2.4 trillion of gross capital investment will be needed between 2023 and 2035 for the UK to be on track to achieve net zero by 2050.[13] The majority of that investment will fund climate solutions that will assist the transformation of the UK's transport, energy and manufacturing sectors.

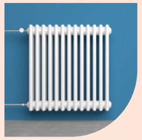
The investment will fund a range of climate solutions in these sectors including solar, low carbon heating, hydrogen and electricity networks. We believe that the UK pension industry - the fourth largest in the world - is well-positioned to support this investment. However, we estimate that only 4% of our industry's assets are currently invested in climate solutions.

In Powering Up Britain, the UK government has highlighted the ten climate solutions and associated policy ambitions that can contribute the most to carbon emissions reduction (Figure 4).[14]

Figure 4 | Main climate solutions needed to deliver UK climate ambition

Efficient insulation

Reduce household energy demand by 15% by 2030[1]



Low-carbon heating

Critical to reducing fossill fuel ussage in buildings

Solar

5x increase in solar capacity needed by 2035

Sustainable aviation fuel

Critical to deliver net zero aviation by 2050

Light EV and charging infrastructure

All new cars to be zero emissions by 2035

Electricity network

Rapid and large scale grid expansion needed to deliver clean energy

Wind

4x increase in offshore wind capacity needed by 2050

Carbon capture and storage

Establish two CCUS clusters by mid-2020s and capture 20-20 MtCO2 p.a. by 2030

Hydrogen

10x increase in hydrogen capacity needed by 2030

Small nuclear reactors[2]

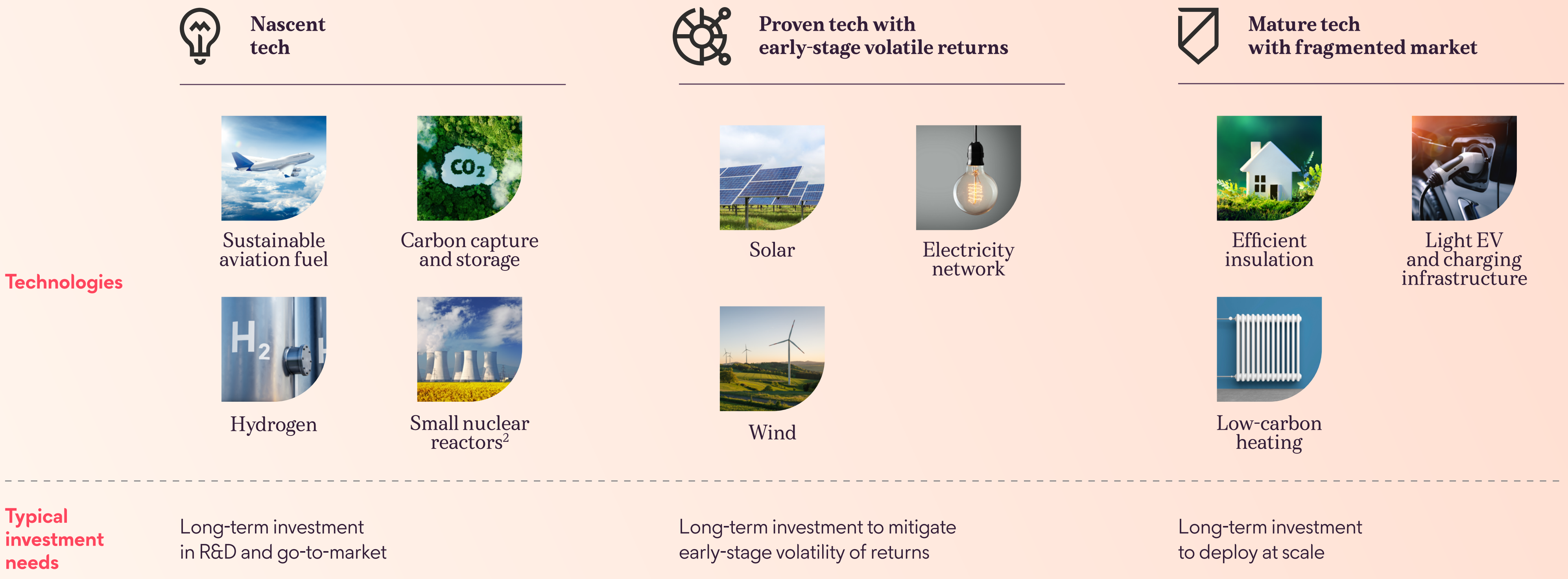
4x increase in nuclear capacity needed by 2050

[1]A low carbon energy system for the UK relies on a significant reduction in overall energy demand. [2]Great British Nuclear supports both conventional and small nuclear reactors but with more focus on R&D and scaling for the latter

Source: Powering Up Britain (DESNZ, 2023)

As summarised in Figure 5, these climate solutions can be grouped into three main categories: nascent technologies, proven technologies with early-stage volatile returns and mature technologies with fragmented markets. The typical investment needs vary by category, but all of them require long-term investment.

Figure 5 | Main climate solutions by category and typical investment needs

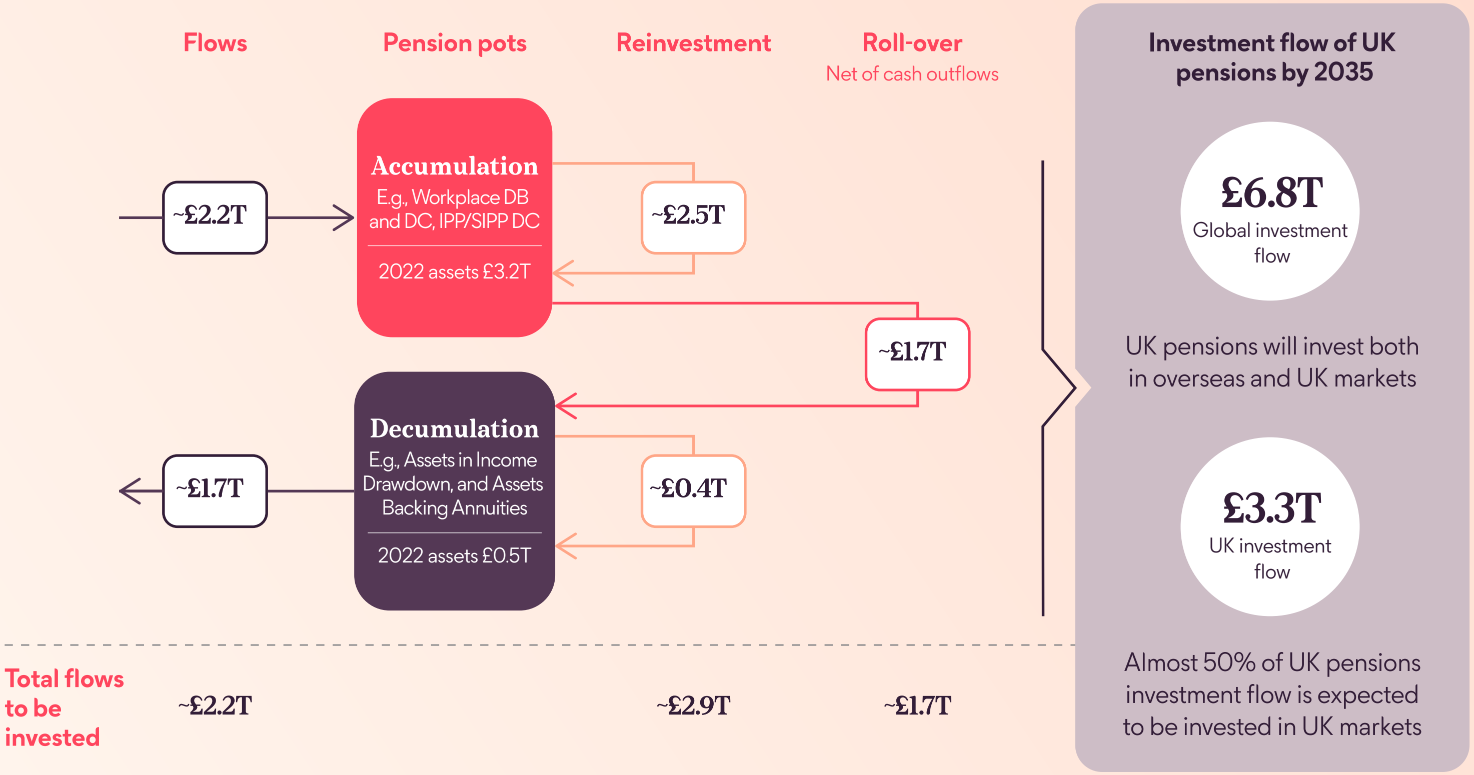


The UK pension industry is growing and well-positioned to invest in climate solutions

Our industry's need for long-term assets that match our long-term liabilities makes us uniquely well-positioned to finance climate solutions, which typically require long-term investments. In addition, investment opportunities in climate solutions are often in 'alternative' assets, which can potentially deliver more attractive yields than 'traditional' asset classes such as listed equity and debt. As active investors, we are also well-positioned to influence the companies we invest in to make greener choices and actively shape a pipeline of climate solution opportunities.

As the fourth largest pension industry in the world, we have the potential to invest in climate solutions at scale. Our industry's assets are projected to grow from £3.7 trillion in 2022 to £6.0 trillion in 2035. Over this period, we will invest £6.8 trillion globally, with overall investment flow generated by three main sources: new flows from savers, reinvestments within pensions pots and roll-over from accumulation to decumulation pots. Approximately half of the overall investment (£3.3 trillion) will be invested domestically in the UK (Figure 6).

Figure 6 | UK pension market investment flow over 2023 – 2035



Note: Sum of 2022 stock and inflows net of outflows does not equal to estimated asset in 2035 due to estimated capital appreciation of ~£1.7T across pension pots.
Sources: Investment Association – Investment Management in the UK 2022-2023 report; ONS June 2023 report; PLSA June 2023 report; UK HoC Work & Pensions Committee 2023; UK Govt Dept for Levelling Up Housing & Communities; The Pension Regulator Annual report 2022

The £3.7 trillion UK pension market is split into accumulation and decumulation pots as summarised in Figure 7.

Accumulation pots – Workplace Defined Benefit (DB), Workplace Defined Contribution (DC), Individual Pension Plan/Self-invested Pension Plan (IPP/SIPP) – are where savers are paying into their pensions to build their retirement funds while they are working. Decumulation pots – Assets in Income Drawdown, Assets Backing Annuities – are where pensioners withdraw money for retirement.

Figure 7 | Overview of the UK pension market

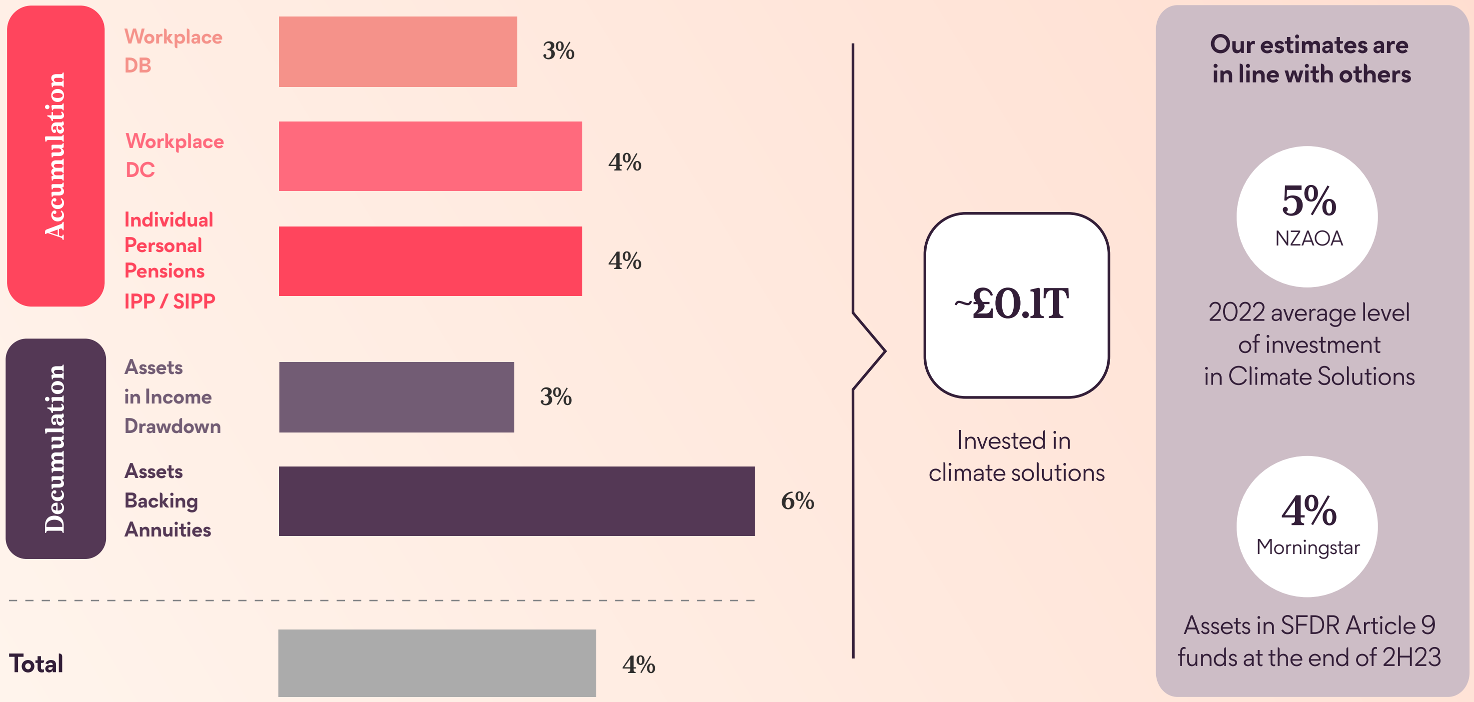
	Pension pool	2022 assets	Overview
Accumulation	Workplace DB (Defined Benefits)	£1.9T	Employer-provided pension schemes with guaranteed income at retirement, based on salary and years of service. While most private sector DB schemes are closed to newcomers, public sector DB schemes like LGPS remain open
Accumulation	Workplace DC (Defined Contribution)	£0.5T	Employer-provided pension schemes, where employees' contributions and employer's contributions are both invested, and the proceeds used to buy a pension and/or other benefits at retirement. The income received in retirement will depend on investments performance
Accumulation	IPP / SIPP (Individual and Self-Invested Personal Pensions)	£0.8T	Personal pension, in which individuals may select both the size of the deposit and the terms of investment from a range of funds that are managed on their behalf. The income received in retirement will depend on the deposits and investments performance
Decumulation	Assets in Income Drawdown	£0.2T	Pension pot where retired individuals are allowed to draw an income from the pension and leave the rest invested. Invested assets are liquid as income drawdown is flexible
Decumulation	Assets Backing Annuities	£0.3T	Pension pot where retired individuals are guaranteed a fixed income. Invested assets are illiquid and subject to withdrawal penalties
	Total	£3.7T	

Sources: Investment Association – Investment Management in the UK 2022-2023 report

We estimate that 4% (around £0.1 trillion) of our industry's £3.7 trillion assets are currently invested in climate solutions, as shown in Figure 8.[15]

This narrow penetration is broadly consistent with other markets around the world. If the current pace of investment in climate solutions continues, our industry's cumulative investment flow in domestic climate solutions will be £0.2-0.3 trillion by 2035. This is roughly 10-15% of the UK's gross capital investment needed in climate solutions. While this level of investment is not negligible, we have the potential to invest considerably more in climate solutions. However, a range of barriers are currently preventing the full realisation of our potential.

Figure 8 | Current UK pension market investment in climate solutions (% assets, 2022)



Sources: Investment Association – Investment Management in the UK 2022-2023 report; UK Govt reporting; Climate Bond Initiative reporting, Bloomberg; Refinitiv; ABI database; Company filings; FTSE Russel; NZAOA – Third Progress Report, October 2023; Morningstar - SFDR Article 8 and Article 9 Funds: Q2 2023 in Review; Pension providers interviews

Understanding the barriers the UK pension industry faces to increasing investments in climate solutions

Fragmentation, riskiness and volatility of returns, coupled with regulatory constraints on pension schemes, currently limit our industry's ability to scale up our investment in climate solutions. The impact of these barriers varies across different pension products and by climate solution.

We have identified two broad barriers that limit the ability of pension funds to finance climate solutions at their full potential.

1. **Demand for finance: Scarcity of scalable opportunities that are suitable for pension funds to invest in**

There are relatively few scalable climate solution opportunities that can offer steady, predictable returns. Many climate solution opportunities tend to be fragmented with riskier and more volatile returns, especially in the early years. When such opportunities do come to market, there tends to be excess capital chasing these deals, which in turn lowers the return and attractiveness of financing them.

It is hard to pick apart the root causes of this scarcity. However, we believe that there are three contributing factors. First, although the UK has a strong climate ambition, it lacks a unified national roadmap with clear milestones to deliver on that ambition. This creates a lack of focus and results in small efforts across a wider range of technologies. Second, entrepreneurs and businesses face significant upfront costs, red tape and delays especially at the beginning of projects. For example, it can currently take up to 13 years from the initial application to secure a connection to the National Grid.[16] This increases the risk of failure and reduces profitability projections. Finally, many climate solutions are hard to scale as they require millions of end-consumers to make expensive changes to their behaviours (e.g. install heat-pumps, insulate homes).

2. **Supply of financing: Regulatory constraints on UK pension industry to investing in climate solutions**

Savers need to have a high degree of certainty about what their retirement pot will be worth; retirees need a predictable cash-flow from which to draw an income. To fulfil our fiduciary duties to them, our industry is selective in the risks we take. There are several constraints that we need to consider — some of them include the liquidity of investment, volatility of returns and customer charges. For example, the current management fee cap makes it unattractive for DC schemes to build the capabilities required to invest in illiquid alternatives. Building those capabilities is more complex and time-intensive – and thus costly – compared to holding an equity position in the same sector. This increase in cost could be offset by charging higher fees, but DC funds are constrained from doing so due to management fee caps.

There are other factors that also play a role. For example, the lack of mandatory, standardised Transition Plans means it is difficult to compare targets and assess progress towards net zero. This makes it harder to celebrate those that are leading the way and to support funds that are falling behind.

> "Fragmentation, riskiness and volatility of returns, coupled with regulatory constraints on pension schemes, currently limit our industry's ability to scale up our investment in climate solutions."

Barriers impact individual pension pots in different ways

As each pension pot has its own specificities and requirements, the impact of barriers varies significantly. Pension pots with strict liquidity constraints and limits on management fees are more impacted by the barrier limiting supply of financing, whereas pension pots with higher shares of illiquid assets and higher management fees are more impacted by the barrier constraining the demand for finance.

- **Workplace DC** and **IPP/SIPP funds** (accumulation) are particularly impacted by regulatory constraints, as liquidity requirements and fee caps render long-term illiquid assets unattractive to investors. In addition, IPP/SIPP funds typically come with independent financial advisers guiding investment allocation, adding a layer of disintermediation in supporting investment decisions.
- Since the majority of **Workplace DB funds** (accumulation) are closed to new members, reduced new inflows in this pot limit its potential to invest in climate solutions. However, a material portion, including ~£0.4 trillion in Local Government Pension Scheme (LGPS) is still open and can contribute to investments in climate solutions.[17] Part of its future allocation will depend on the outcome of emerging guidance from the government consultation on doubling existing LGPS investments in private equity to 10%, which was part of the 2023 Mansion House Reforms.[18]
- **Assets Backing Annuities** (decumulation) could be an ideal fit for climate solutions because their asset allocation is skewed towards long-dated illiquid debt (e.g. private debt, real estate) and because they can charge higher management fees that can cover the cost of illiquid transactions. But the scarcity of scalable opportunities in climate solutions, particularly the volatility of returns for early-stage technologies, makes it hard for this pension pot to obtain stable yields and limits an increase of investments. Even when illiquid debt opportunities are available, they may not yield optimal risk-adjusted returns compared to other opportunities. To justify such investing an investment that may be relatively less attractive on economics, which can mean necessitates a need to put greater emphasis evaluation on the productive/sustainable benefits on a system-wide or economy-wide basis.
- Investments in **Assets in Income Drawdown** (decumulation) need to be highly liquid and de-risked to safeguard pensioners' incomes and standard of living, which is not an optimal fit for illiquid climate solutions.

Refer to Figure 7 on page 18 for an overview of pension pots in the UK pension market.

Impact of barriers also varies by climate solution

Different climate solutions are impacted by both barriers to different extents. Nascent technologies often involve illiquid high-risk projects with high transaction costs, rendering them sensitive to the regulatory constraints on the UK pension market. Proven technologies, on the other hand, are often susceptible to early-stage volatile returns, which could limit their investibility. Mature technologies with fragmented markets face the problem of scalability, and thus are not immediately attractive to investors.

Addressing these barriers in the right way will not be easy. Nevertheless, mitigating them is critical for our industry to invest in climate solutions at their full potential.

Chapter 3

Strategies for unlocking investment in climate solutions

We have identified seven strategies for policymakers and regulators to address the barriers currently limiting investment in climate solutions. Implementing them and collective action accordingly could contribute towards enabling the UK pension industry to triple its investment in climate solutions to £0.8-1.2 trillion between now and 2035. This would represent 30-50% of the total UK investment needed for net zero.

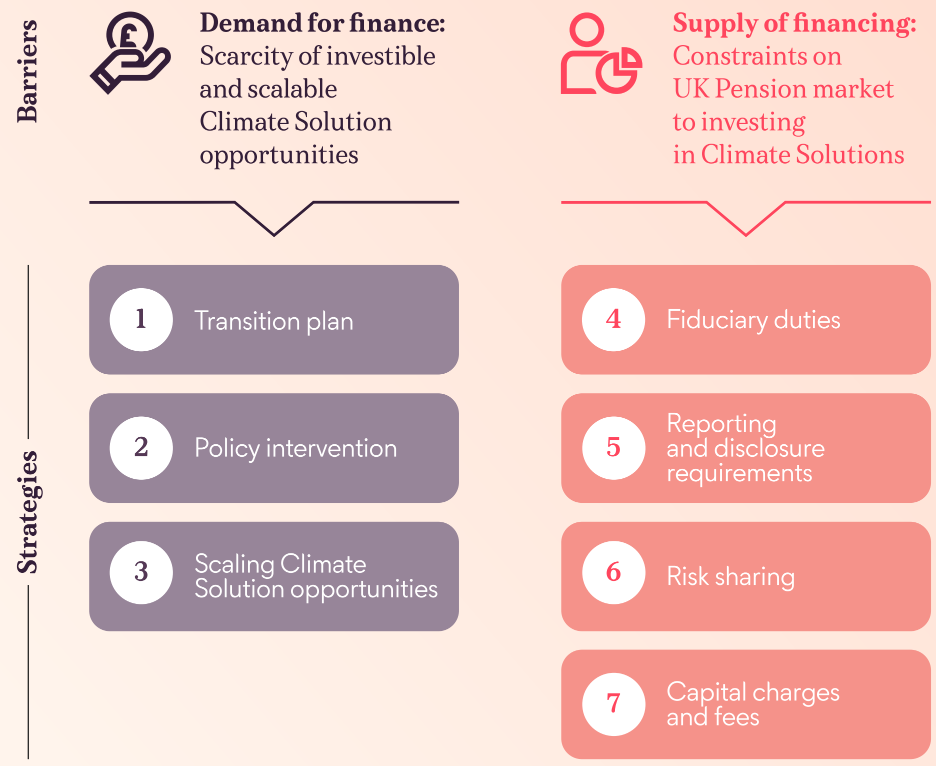
Strategies for unlocking investment in climate solutions

We propose seven strategies for policymakers and regulators to unlock greater investment in climate solutions from the UK pension industry. We highlight four priority strategies in the short-term due to their high potential impact and relative ease of implementation. We also outline a range of steps for our industry to take in the near-term.

Seven strategies to overcome the barriers

Out of the seven strategies we have identified (Figure 9), three of them address the scarcity of opportunities ('demand for finance' barrier), and four of them address the regulatory constraints ('supply of finance' barrier). None of the seven strategies start from a blank page. However, accelerated efforts are required in all seven areas to fully enable our industry's investment potential in climate solutions.

Figure 9 | Strategies to mitigate the barriers



1. Transition plan

The UK should develop an economy-wide transition plan that defines the range of sector-specific strategies, roadmaps with clear milestones and policy instruments to support low-carbon investments. A National Transition Plan should build upon Powering Up Britain, the Climate Change Committee (CCC) Carbon Budget and DESNZ's climate solution-specific net zero investment roadmaps.[19] It should articulate energy sector strategies (such as offshore wind and grid updates) that are fully aligned with national climate commitments, as well as capital-raising plans that define investment needs across sectors. To complement these strategies, it should align carbon pricing across high-emitting sectors through measures such as tightening the emissions cap and expansion to new sectors to incentivise a transition to lowering emissions. Given the need for sustainably increasing electrification, the UK Government should outline a clear approach to gas vs electricity 'rebalancing' in order to generate the clear short-term price signal necessary to shift both households and businesses to lower-carbon, energy-efficient technologies like heat pumps. The transition plan should include how a Just Transition will be achieved in high-emitting sectors and ensure that skills needs and job-creation opportunities across sectors are considered. Lastly, it should contain detailed plans for reducing reliance on fossil fuels, which will help investors assess the attractiveness of assets in sectors that rely heavily on them and allocate capital accordingly.

The production of a National Transition Plan would provide a clear market signal and substantially reduce uncertainty, paving the way for private finance to allocate capital in support of the net zero transition.

2. Policy intervention

Long-term policy certainty and incentives are key to attracting investors. Policy interventions aimed at reducing volatility of climate solutions' returns or abating costs for early-stage technology providers often provide the most certainty for investors. The UK has led the way in scaling up offshore wind capacity through contracts for difference (CfD) policy which demonstrates the impact of the right policy interventions. The government can build upon that by expanding CfDs to new sectors such as hydrogen, Carbon Capture, Utilisation and Storage (CCUS) and sustainable aviation fuel. It can also offer tax incentives, grants, interest free loans or subsidies for climate solutions (e.g. upgrading assets with CCUS, efficiency, electrification). Additionally, it can provide tax relief for companies who invest in nascent climate solutions such as green hydrogen, and remove tax relief for research and development in fossil fuel extraction.

3. Scaling climate solution opportunities

Government initiatives that accelerate the deployment of new technologies, aggregate fragmented investment opportunities and provide consistent planning regimes at the national level will help to scale up the supply of climate solutions across the UK. Great British Nuclear is a good example of how the government can support the construction of large-scale infrastructure required for certain kinds of low carbon technology.[20] The government could expand upon that and outline a consistent planning and permitting regime that prioritises the construction of climate solution infrastructure as a whole. This would help to lower the administrative burden for new technologies (e.g. local content rules) and accelerate approvals for large infrastructure projects. Additionally, the government could launch a UK Investment Hub to aggregate demand for climate solutions (e.g. Local Net Zero Hubs, Net Zero Go platform) and to provide centralised sources of research and expertise (such as compliance and legal knowledge). Other potential initiatives include securitisation programmes that are structured to scale up adoption of climate solution technologies and centrally co-ordinated programmes, administered regionally across the UK, that could roll out key low carbon infrastructure, such as EV charging infrastructure.

4. Provide clarity on considering climate impact as part of fiduciary duties

Fiduciary duties can be inconsistently interpreted across our industry. Providing clarity on how to consider climate risk and its effect of investments in a long-term prudential strategy will help our industry integrate the net zero transition into investment decisions and engage investee companies. This will require a combined effort from government, pension providers and the legal community. As highlighted by the PRI's report, A Legal Framework for Impact, examples include adjusting guidance on fiduciary duties for trustees to weigh climate change and the net zero transition in their investment decisions as part of their duties of loyalty, care and prudence, as well as clarifying that purpose-related requirements entail consideration of sustainability impacts.[21] It is important to note that this should not override the core objective of acting in the beneficiaries' best financial interests. To assist our industry, The Pensions Regulator (TPR) should be clear that climate impact investment decisions are important to its goal of ensuring the security of pensions.

5. Reporting and disclosure requirements

Requirements that improve reporting transparency and standardise reporting on investment in climate solutions will provide greater clarity both to investors and to consumers who are choosing where to invest in climate solutions. Examples of initiatives include accelerating the development of UK's Sustainability Disclosure Requirements,[22] requiring all UK firms to develop and disclose Net Zero Transition Plans according to the Transition Plan Taskforce (TPT) framework,[23] finalising UK Green Taxonomy by Green Technical Advisory Group (GTAG)[24] and setting a timeline for taxonomy-aligned reporting.

6. Risk-sharing

Risk-sharing mechanisms between investors and government (central and local) can be effective ways of 'crowding in' private finance by altering the risk-return profile of investments to make them more attractive to long-term investors. This could be delivered through the creation of pooled investment structures or direct investments that are enabled by the UK government through a variety of structural enhancements, such as government guarantees/first loss ownership, direct investment or co-investment by the government. Strengthening Public-Private Partnerships (PPPs) at national and local levels to secure the long-term finance needed to achieve net zero targets is key to crowding in private finance. Moreover, it can share risk assessments of projects (including insurance-related risks) to reduce the cost of research for investors, although current widespread fiscal challenges may make this difficult.

Lastly, blended finance instruments can help attract private investment and, at the same time, balance risks, which would help budget-constrained organisations in addressing economic, environmental and social challenges.[25] In this sense, direct intervention from UK Infrastructure Bank and British Business Bank may be of particular interest in scaling up these solutions.

7. Capital charges and fees

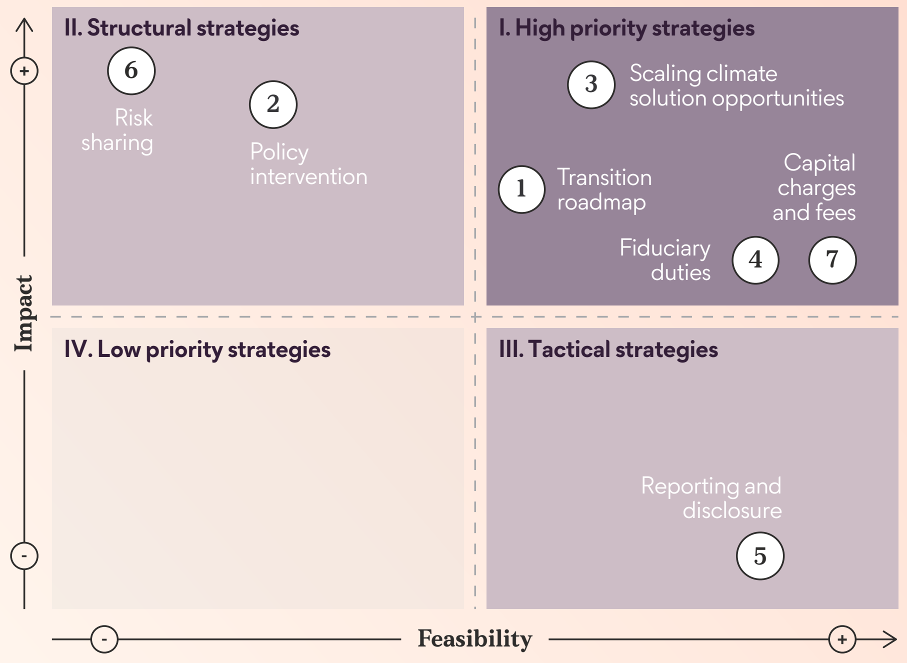
There are ongoing regulatory consultations that would make investment in climate solutions more appealing for the pension industry, and accelerating these should be a key strategic priority. One example is the reform of Solvency II UK for insurers, which is critical to helping long-term financial institutions invest with confidence. We believe that the resulting capital freed up for investment should be targeted at productive and sustainable finance including climate solutions, so long as it is in customers' financial interest. The government should, where necessary, give investors confidence and regulatory certainty by setting out the key outcomes it intends to deliver through the reforms. These outcomes can act as guardrails for the various industry regulators who are implementing the changes. Lastly, the government could consider exempting fees related to investing in climate solutions from the DC regulatory charge cap.

"There are ongoing regulatory consultations that would make investment in climate solutions more appealing for the pension industry, and accelerating these should be a key strategic priority. One example is the reform of Solvency II UK for insurers, which is critical to helping long-term financial institutions invest with confidence."

Four high-priorities strategies in the short-term

We have assessed each of these seven strategies based on their potential impact and feasibility. The 'impact' assessment considers each strategy's potential to boost investment in climate solutions, given the current UK political and economic environment. The 'feasibility' assessment considers which strategies are the easiest to implement in the short-term, taking into consideration the current economic environment and fiscal constraints (Figure 10).

Figure 10 | Prioritisation of strategies in the short-term



Based on this analysis, policymakers' and regulators' primary focus over the next 12 months should be on the four high priority strategies. We acknowledge that each of them involves multiple stakeholders who all need to play a proactive role, but in the list below we highlight the stakeholders who are best positioned to kickstart change:

- Develop National Transition Plan with sector-specific strategies and clear roadmaps (#1) - Department for Energy Security and Net Zero alongside HM Treasury
- Outline a consistent planning and permitting regime to prioritise the go-to-market and scaling of climate solutions - (#3) - Department for Levelling Up, Housing and Communities
- Provide clarity on how to consider climate impact as part of fiduciary duties (#4) - Department for Work and Pensions (DWP)
- Lower capital charges for insurers and fees for DC schemes (#7) - Prudential Regulation Authority (PRA)

Some of these prioritised strategies are clearly more relevant to particular climate solutions than others. For instance, Strategy #3, "Scaling climate solution opportunities," is most suitable for mature technologies that do not require further research and development and offer stable returns; they mainly need additional investment to enable scale. Examples include EV charging infrastructure and insulation. The UK government currently provides consumer grants to encourage higher adoption of these technologies, such as the Great British Insulation Scheme (~£1 billion for 300,000 homes to install efficient insulation).[26] Accelerating the roll-out of these mature technologies would require centrally co-ordinated programmes administered regionally across the UK, which would reduce market fragmentation.

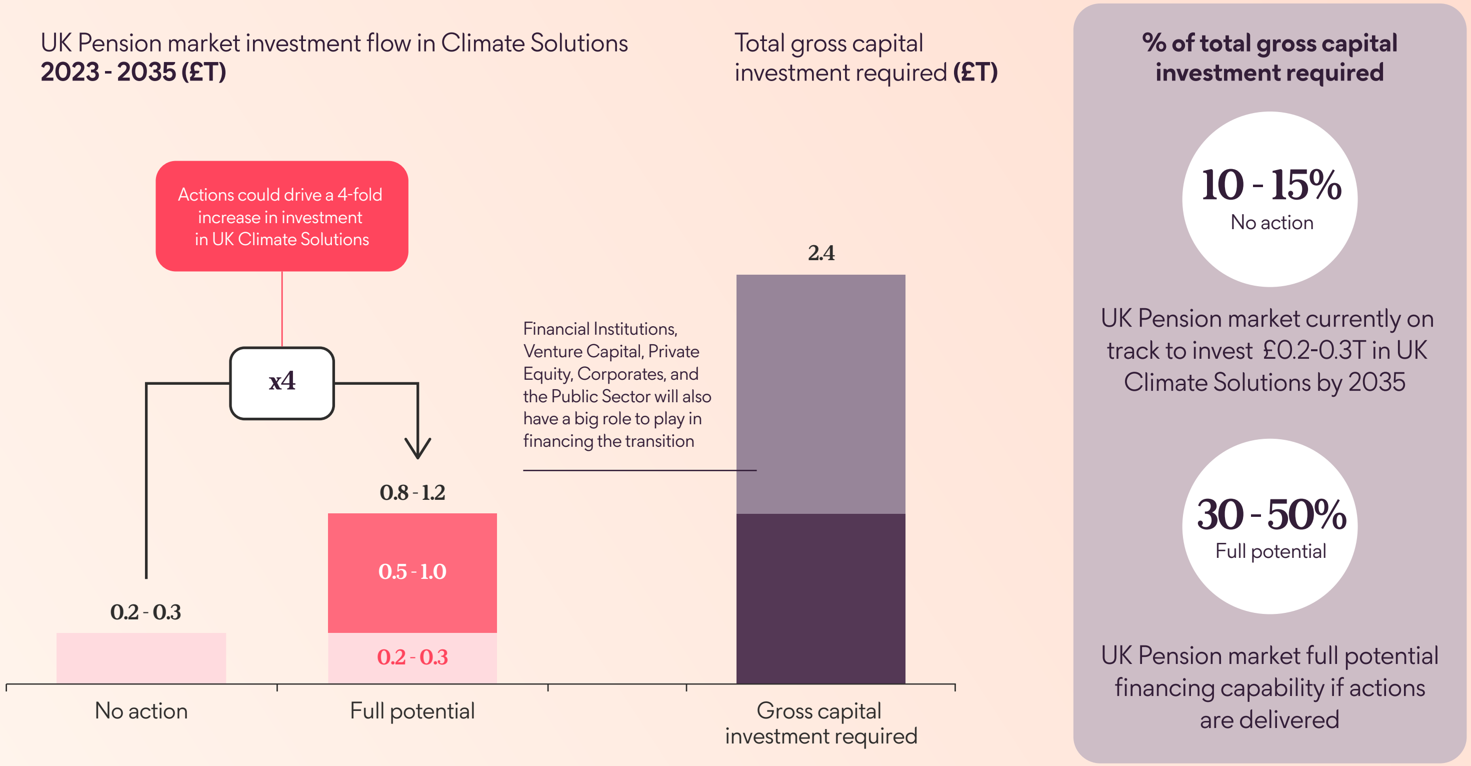
Whilst there are numerous short-term measures for government and regulators to prioritise, there are also important measures to adopt in the medium and long-term. The implementation of a transparent disclosure and reporting regime, for example, would enable to investors to make more informed investment decisions on their capital allocation, further speeding up the transition to net zero. Transparent disclosures, however, should not further burden investors and increase costs to customers.

Implementing the strategies could help enable the UK pension industry to invest £0.8-1.2 trillion in UK climate solutions between now and 2035

Implementing the proposed strategies to mitigate current barriers could help the UK pension industry quadruple its investment flow in climate solutions from £0.2-0.3 trillion to £0.8-1.2 trillion by 2035 in a way that delivers value to customers. This amounts to 30-50% of the overall gross capital investment needed in the UK over this period (Figure 11). The wide range in our calculation reflects the numerous uncertain variables involved in making estimates over a time horizon of 10+ years.

It is important to note that the timing, order of implementation and dependencies between strategies can affect their estimated potential impact. Additionally, we acknowledge that, even if all strategies are successfully implemented, unlocking the full investment potential is still subject to external macro-economic factors.

Figure 11 | UK pension market investment flow in climate solutions 2023 – 2035



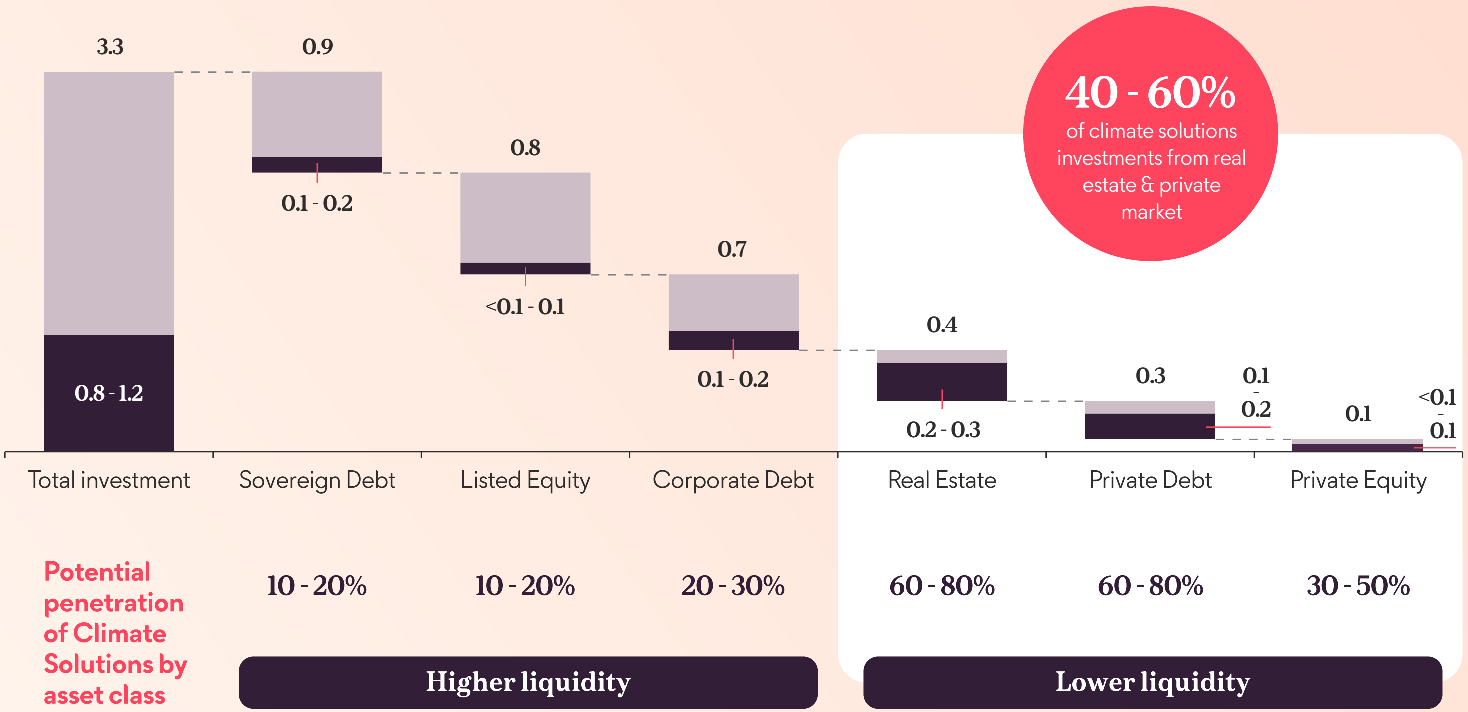
Note: Totals may not add up due to rounding
Sources: Investment Association – Investment Management in the UK 2022-2023 report; UK Govt; CBI; Eurostat; Goldman Sachs; Bloomberg; FTSE Russell; PitchBook; IEA; Preqin; Refinitiv; Pension Providers Interviews

According to our estimates, 40-60% of the investment in climate solutions will be allocated towards low liquidity asset classes, as shown in Figure 12.

Climate solutions, such as green buildings and infrastructure projects, tend to require more illiquid, long-dated financing because they are capital-intensive and have long payback periods. This renders them a good match for private debt and real estate investors, who are well-positioned to provide long-term investments with predictable cash flows. Note that we are not assuming any fundamental shift in strategic asset allocations. For more details, see the Appendix.

Delivering the financing for the net zero transition will require the support of many institutions and sectors in the UK beyond the pension industry. But our industry is uniquely positioned to play a major role in financing this transition, so long as we overcome the barriers to unlock significant investment in climate solutions in a way that delivers value to customers.

Figure 12 | UK pension market investment flows in the UK by 2035 by asset class



Note: Totals may not add up due to rounding

Sources: Investment Association – Investment Management in the UK 2022-2023 report; UK Govt; CBI; Eurostat; Goldman Sachs; Bloomberg; FTSE Russell; PitchBook; IEA; Preqin

The UK has made progress on some of these strategies

There are many positive initiatives underway in the UK that have been led by the government, regulators and industry. Figure 13 summarise some key examples, although they are not intended to be exhaustive.

As long-term investors, our industry welcomes clear, supportive policies and regulations that aim to transform sectors across the economy to transition to net zero. For instance, the 2023 Mansion House Reforms has been a positive first step to enabling more investment in climate solutions.[28] We note that in July 2023, the UK government presented the outcome of a consultation on a Value for Money assessment framework for DC schemes, in which some responders suggested that ESG considerations should be included in the framework (although this is an area of ongoing debate). Meanwhile, CfDs have not only increased our investments in climate solutions but are also poised to deliver wider benefits to the UK economy, including supporting the creation of around 90,000 jobs.[29]

The government has also taken effective steps in creating a market for a public good, such as clean air or renewable energy, where one does not already exist. As already successfully demonstrated by the Green Investment Bank (GIB) with wind energy, once the market has been created, the Government can exit the financing arrangement leaving a sustainable private funding model for the future.[27]

Figure 13 | Examples of ongoing initiatives in UK, mapped to our seven strategies

Not exhaustive

	Strategies	Example initiatives in UK
Scarcity of opportunities	1 Transition plan	**"Powering Up Britain"** and **"Powering Up Britain: Net Zero Growth Plan"; Offshore Wind Net Zero Investment Roadmap**
	2 Policy intervention	**Contracts for Difference (CfD)** to support low-carbon electricity generation from offshore wind
	3 Scaling Climate Solution opportunities	**Great British Nuclear** to support and speed up construction of large-scale projects as well as emerging nuclear technologies
Constraints on UK Pension market	4 Fiduciary duties	PRI advocating for clarity on considering climate impact as part of **fiduciary duties** (2022); stewardship activities in **Green Finance Strategy** (March 2023)
	5 Reporting and disclosure requirements	**GTAG** (UK Green Taxonomy); UK Sustainability Disclosure Standard (**SDS**); and UK Sustainability Disclosure Requirements (**SDR**); **TPT** (Transition Plan Taskforce) **Disclosure Framework** on comparable transition plan disclosures
	6 Risk sharing	**Bristol City** (commitment to be CO_2 neutral by 2030); **UK govt statistics** to reduce cost of research (e.g., student loans in 2018); **UKIB local authority lending** for infrastructure projects including climate solutions
	7 Capital charges and fees	**Mansion House reforms, UK Solvency II reform** (ongoing), **exemption of some performance-based fees** from DC regulatory charge cap

How the UK pension industry can immediately push forward

While the UK pension industry is heavily dependent on supportive policy and regulation to unlock our full potential to invest in climate solutions, there are still actions that could be taken ourselves:

1. Doing the basics right

- Define clear net zero transition targets and timelines within existing frameworks (e.g. NZAOA, IIGCC)[30]
- Establish governance measures that provide accountability for transition plans
- Integrate climate considerations in the investment process and in the mandates of asset managers
- Use stewardship to support achievement of net zero targets
- Upskill across the industry on climate opportunities and risks
- Align disclosures across transition plan and sustainability reporting, with the TPT standards and upcoming Green Taxonomy by the GTAG

2. Innovation within the industry

- Work to improve climate scenarios and modelling tools to better reflect potential transition and physical risks in investment portfolios
- Develop new green investment and insurance products as compelling value propositions
- Collaborate with peers and public funding bodies to develop new business models that can unlock transformation at scale, such as blended financing and securitisation. The Net Zero Coalition and ABI Investment Delivery Forum are good examples of industry collaboration already underway.

3. Advocacy for broader system change

- A critical first step that can be taken now is to engage directly with government and regulators. This engagement can inform the debate on the net zero transition and lobby for the strategies outlined in this report to be implemented to enable greater investment.

Pensions and Climate Solutions: the View from Savers

With the introduction of auto-enrolment in 2012, millions of people across the UK began contributing to their pensions, including many younger savers for the very first time.

Now, over ten years since this legislation was enacted, an estimated 28.5 million "non-retiree" adults are adding to their pensions each year, a record figure for the UK pensions industry which, in total, manages a staggering £3 trillion of savers' money. This growth in numbers is also coinciding with a shift in attitudes, as the public is increasingly aware of the links between their money and climate change.

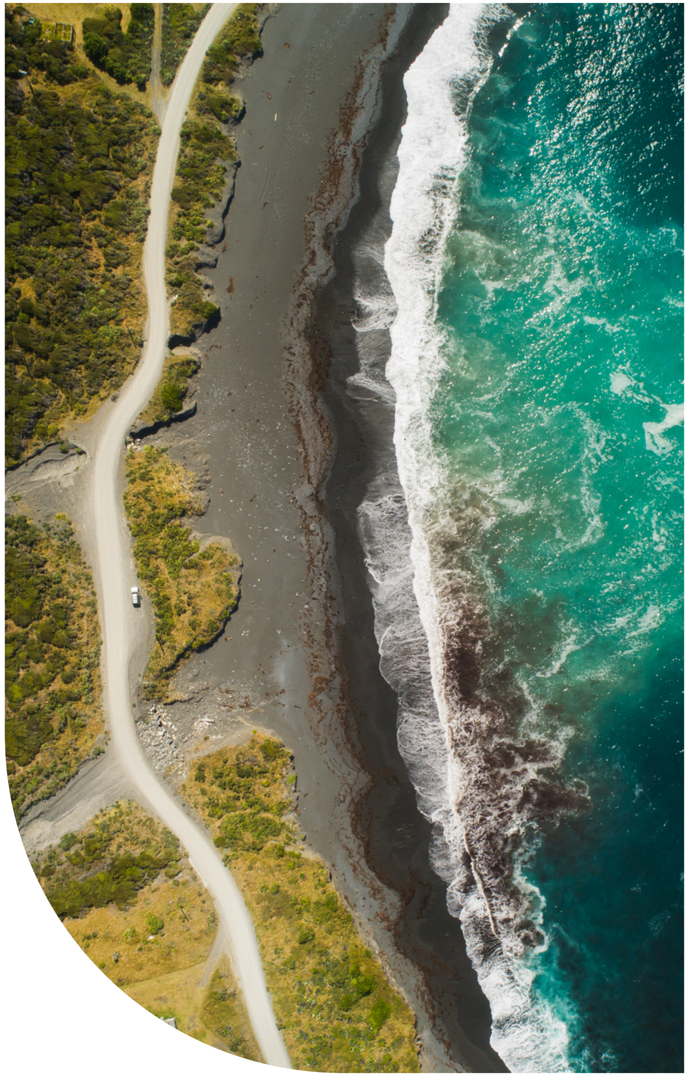
From tackling deforestation to driving emissions reductions, savers are recognising the power of their pensions in tackling the climate emergency and are expecting action from those managing their money. In fact, over 60% of UK citizens say that they want their pensions to play an active part in fighting climate change. These beliefs are even stronger when it comes to maximising the positive impacts of pensions.

New research from Make My Money Matter and NEON shows that two thirds (66%) of all pension holders support their scheme's investments in renewable energy, while even more (68%) support investments in companies that protect natural habitats. For comparison, just 19% of pension holders support their scheme's investments in fossil fuels. These beliefs are solidifying, particularly amongst the younger generations who are facing the worst impacts of a changing climate.

Among 18 to 34-year-olds with a pension, over 50% want their scheme to actively ramp up their investments in climate solutions beyond current levels, while 62% say they plan to switch to a more sustainable pension in the coming 12 months.

This research shows that a different conversation about pensions is emerging. A conversation where savers see the power of their pensions and want their money to matter. A conversation which recognises the role our pensions have – not just in building healthy returns, but also building a healthy planet for retirement.

For schemes that want to engage current and future pension holders, joining this conversation – and meeting saver expectations with clear action – has never been more important.



Investing beyond the UK

Currently, 80% of climate finance is concentrated in Europe, North America and China.[31] To reach net zero globally by 2050, the allocation of climate finance needs to be significantly expanded to other regions, especially emerging markets and developing economies (EMDEs). Investment-to-date within EMDEs has so far been very limited, despite pressing needs in these regions, which are likely to emit more than half the annual global total of greenhouse gas emissions as early as 2030.[32]

As summarised in Figure 14, there are numerous compelling reasons for the UK pension industry to invest in EMDEs in particular. EMDEs could potentially offer access to a new pipeline of climate solution investment opportunities, while offering portfolio diversification for pension funds and enabling a just transition globally. However, investing in EMDEs comes with other risks and costs. In addition, many UK pension market players lack deep knowledge and expertise on the dynamics within each EMDE. Some of the barriers include:

- **Financial and risk-return profile:** Investors in EMDEs face higher financial risks such as foreign exchange risk and counterparty credit risk.
- **Governance, political & regulatory risks:** EMDEs are more exposed to geopolitical and social risks (e.g. wars, civil conflict), poor governance (e.g. corruption) and regulatory constraints (e.g. long and unclear approval processes for infrastructure projects).
- **Additional costs for closing deals:** Higher upfront and transaction costs as well as the higher cost of capital in EMDEs can reduce project attractiveness. Reporting requirements in EMDEs differ from OECD nations, resulting in a lack of high-quality climate and performance data for assets and higher cost of analysis and research before investing.
- **Lack of knowledge and expertise:** UK pension funds often lack sufficient knowledge and expertise on the specific market and technology risks in EMDEs.

Figure 14 | Reasons for and barriers to UK pensions investing in EMDEs

There are good reasons to invest in EMDEs	Additional hurdles
Exposure to higher growth economies	**Additional financial risks** e.g., currency
Attractive returns	**New (country) risks** e.g., political, regulatory
Portfolio diversification	**Additional costs** e.g., deal costs, cost of capital
Just Transition	**No local expertise/experience** e.g., market insight

Not exhaustive

There is a role for pension players – in the UK and other developed markets – to collaborate with multilateral development banks and other market participants in the blended finance space to either directly invest in transition projects in EMDEs or enable the movement of private capital towards EMDEs more broadly.

Assuming the current trends in overseas investment continue, the UK pension industry will invest some £3.5 trillion internationally between now and 2035, of which £2.2 trillion will be allocated to listed equity, £1.0 trillion to sovereign and corporate debt, and £0.2 trillion to private debt, private equity and real estate.[33] Within listed equity, only 25% is invested in EMDEs. An estimation of potential investment in climate solutions within EMDEs is out of the scope of this report, as it is highly country-specific.

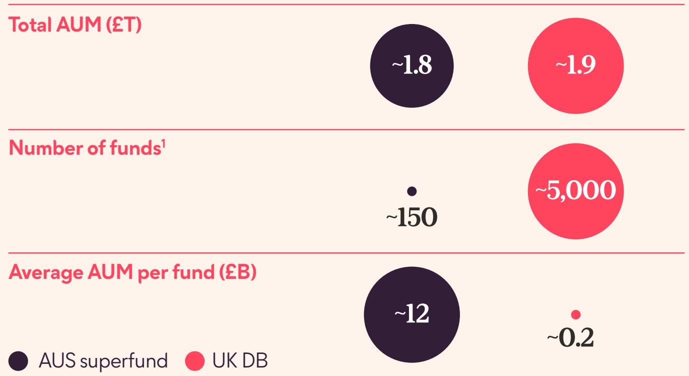
Australia is an example of a different pension market that has invested in climate solutions locally and internationally, including in EMDEs (Figures 15 and 16). Australia's consolidation of its pension industry has allowed investment at scale, and while we acknowledge it operates in a different context than our pensions industry, its success serves as a useful case study.

Figure 15 | Consolidation of Australian Pensions[34]

Since 1993, Australia has introduced regulations to consolidate and invest in Climate Solutions:

- Setting **default funds** for mandatory contributions
- Increasing **regulatory oversight**, including performance testing
- Giving **tax incentives** for funds to merge

As a result, the number of funds in Australia has fallen from **~400 to ~150**[1] since 2010

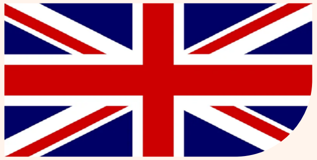


Not exhaustive

Note: Data as of September 2023 1. Excludes funds with less than 7 members
Source: ASFA; Investment Association – Investment Management in the UK 2022-2023 report

Figure 16 | Australian superannuation funds invest in climate solutions locally and abroad[35]

Superfund investments now make up ~10% of Australia's renewable energy capacity



Superfund-owned IFM Investors have committed £3B in UK infrastructure investments (including renewable energy) over next 5 years

Aware Super invested ~£1B in renewable energy globally, including in Emerging Markets

Not exhaustive

Source: ASFA, IFM Investors, Aware Super

Chapter 4

Call to action

We have identified the highest priority actions for government, regulators and the pension industry to undertake in the next 12 months – all of whom have crucial roles to play. We plan to use this report a platform for the next phase of our work to drive the wider system change needed to unlock the UK pension industry's full potential to invest in climate solutions in a way that delivers value to customers.

Call to action

This report is intended to shine a light on the huge opportunity for our industry to scale up our investment in climate solutions in a way that delivers value to customers. In doing so, we hope to catalyse further debate, collaboration and innovation that is needed to make it happen. Ultimately, though, this report needs to translate into action. Figure 17 summarises the key priorities we have identified for government, regulators and the pension industry where action is most needed – and most achievable – over the next 12 months

Figure 17 | Prioritised actions for UK government, regulators and pension industry

Government & Local authorities

Transition plan

- Develop **UK climate transition plan** with sector-specific strategies and clear roadmaps

Scaling climate solution opportunities

- Outline a **consistent planning and permitting regime** to prioritise and to accelerate climate solution infrastructure build
- Build local hubs that **aggregate demand and provide expertise** (e.g., Local Net Zero Hubs, Net Zero Go platform)

Industry Regulators & associations

Fiduciary duties

- Provide clarity on considering climate impact as part of **fiduciary duties**

Capital charges and fees

- Deliver **matching adjustment** reform (Solvency UK)
- Consider **exemption of climate solutions fees** from DC charge cap

UK pensions

Innovation

- Develop **new green products and insurance products**
- Adopt best in class **climate financial models**
- Collaborate with peers and public funding bodies to **develop new business models**

Doing the basics right

- Articulate **a clear strategy to grow investments** in climate solutions
- Upskill **across the industry** on climate opportunities and risks
- Use **stewardship** to support achievement of net zero targets

At Phoenix Group, we plan to use this report as a platform for the next phase of our work to drive wider system change. As set out in our Net Zero Transition Plan, we will do this in three ways:

- **Thought leadership:** Delivering impactful thought leadership that offers potential solutions to policy and regulatory barriers that are currently hindering the net zero transition.
- **Engagement:** Engaging with regional, national and international policy makers, regulators and local government to inform the debate on the net zero transition in the economy.
- **Collaboration:** Collaborating with our peers directly and through cross-sectoral bodies to develop new business models and end-to-end solutions required to unlock transformation at scale.

By acting on the recommendations in this report, government, regulators and pension players will help our industry lend its full weight towards investing in climate solutions, both in the UK and internationally. Doing so will not only help to tackle climate change, but it will also deliver wider economic and social benefits. By investing in the right way for our customers, enabled by supportive policy, regulatory and market conditions, we will help deliver a just transition for all and help our customers grow their investments and secure a life of possibilities.

"We know that we cannot deliver net zero alone and are committed to engaging constructively with government and regulators to help drive the wider system change needed to unlock exciting opportunities to significantly scale up investment in the net zero transition."

James Wilde,
Chief Sustainability Officer,
Phoenix Group

Appendix

Overview of methodology

Investment flow in 2023-2035 is estimated considering inflows and outflows from/to savers, as well as reinvestment within pension pots and roll-over from accumulation to decumulation pots. Investment flow is allocated to asset classes and to UK geography according to current allocation by pension pot.

Current penetration of climate solutions by asset class is estimated based on triangulation of different data sources, proprietary data and interviews with market experts, with the results summarised in Figure 18. Assumptions used for potential penetration of climate solutions is described in Figure 19.

Figure 18 | Penetration of climate solutions by asset class

Asset Class	Current penetration of Climate Solutions	Full potential penetration of Climate Solutions	Example of Climate Solutions Investments
Sovereign debt	0 - 5%	10 - 20%	UK Green Gilts
Listed equity	0 - 5%	10 - 20%	Best-in-class ESG strategy
Corporate debt	1 - 5%	20 - 30%	Climate corporate bonds (e.g., CBI Climate Certified Bonds)
Real estate	0 - 10%	60 - 80%	Real estate assets meeting net zero standards
Private debt	10 - 20%	60 - 80%	Private debt financing offshore wind farm
Private equity	0 - 5%	30 - 50%	Private equity and venture capital funding R&D or technologies' project development

Low — High

Sources: UK government; Climate Bond Initiative; Bloomberg; Refinitiv; ABI database; Investment Association; Company filings; FTSE Russell; Pension providers interviews

Figure 19 | Potential penetration of climate solutions estimation and rationale

Asset Class	Investment flow in UK 2023 - 2035 (£T)	Potential UK penetration of Climate Solutions (%)	Potential UK investment in Climate Solutions 23 - 35 (£T)	Rationale for range in potential penetration of Climate Solutions in UK market
Sovereign	0.9	10 - 20%[1]	0.1 - 0.2	Current UK penetration assumed to grow at 25-30% CAGR to 2035, lower than past 3-years CAGR of ca.35% of European sovereign green bonds issuance
Listed Equity	0.8	10 - 20%[4]	<0.1 - 0.1	Current penetration assumed to grow at ca.5% CAGR to 2035, in line with observed CAGR of ca.5% of market penetration of equity "green economy" over last 12 years
Corporate Debt	0.7	20 - 30%[2]	0.1 - 0.2	Current UK penetration rate assumed to grow at ca.20% CAGR to 2035, lower than past 5yrs CAGR of ca.35% of European corporate green bonds issuance
Real Estate	0.4	60 - 80%[6]	0.2 - 0.3	Current UK penetration rate of assumed to grow driven by large investments in building sector (all new buildings need to be zero-carbon-ready by 2030), in line with projected growth of ESG AuMs for Real Estate and Infrastructure of ca.35% in Europe to 2025
Private Debt	0.3	60 - 80%[3]	0.1 - 0.2	Current UK penetration rate assumed to grow significantly since majority climate solutions investments expected in private debt, aligned with increase in penetration of sustainable transactions in EUPP CAGR of ca.35% between 2019-22
Private Equity	0.1	30 - 50%[5]	<0.1 - 0.1	Current UK penetration rate assumed to grow driven by investments in climate tech companies, in line with CAGR of ca.40% of global climate-related PE/VC investments over the last 3yrs
Total	3.3		0.8 - 1.2	

Note: Totals may not add up due to rounding. "Green economy" is low carbon, resource efficient and socially inclusive economy. EUPP is Euro Private Placements
Sources: Investment Association – Investment Management in the UK 2022-2023 report; UK Govt; CBI; Eurostat; Goldman Sachs; FTSE Russell; Bloomberg; PitchBook; IEA; Preqin; Pension providers interviews

How barriers are impacting pension pots and technologies

Figures 20 and 21 show, in detail, how barriers on demand and supply of funds for climate solutions have a different impact on depending on the pension pot and transition technology.

Figure 20 | Impact of barriers on pension pots

Pension pool	Investment flow 2023 - 2035 in UK	Fit for Climate Solutions	Critical barriers	Rationale
Workplace DB	~£0.3T	Medium	UK Pension constraints	• **Majority of private schemes closed to new members** reduces potential to invest in Climate Solutions
Workplace DC	~£0.9T	Medium/High	UK Pension constraints	• **Liquidity constraints** and **low fees** reduce attractiveness of long-dated illiquid assets • **Fiduciary duties** currently limit riskier holdings in default funds and **low customer/employer engagement** means few switch out of the default into greener funds
Individual Personal Pensions IPP / SIPP	~£0.6T	Medium	UK Pension constraints	• IPP/SIPP funds have additional complexity around engaging with independent financial advisers who typically advise customers on investment allocation
Assets in Income Drawdown	~£0.5T	Low	UK Pension constraints	• Pensioners actively drawing down assets, therefore investments need to be **highly liquid** and **de-risked** to safeguard pensioners' income and standard of living
Assets Backing Annuities	~£1.0T	High	Scarcity of opportunities	• **Asset allocation is skewed towards long-dated illiquid debt which is an ideal fit** for investing in climate solutions given the long-term nature of the liabilities • **Higher fee structure** allows funds to cover costs of illiquid transactions
Total	**~£3.3T**			

Scarcity of opportunities · UK Pension constraints

Note: Totals may not add up due to rounding; Estimates are subject to thresholds for asset eligibility, pricing vs. investment hurdles etc. being met

Figure 21 | Impact of barriers on transition technologies

	Nascent tech	Proven tech with early-stage volatile returns	Mature tech with fragmented market
Technologies	Hydrogen, Sustainable aviation fuel, Carbon capture and storage, Small nuclear reactors[2]	Solar, Electricity network, Wind	Efficient insulation, Light EV and charging infra., Low-carbon heating
Main barriers	High-risk/nascent projects tend to involve more illiquid investment	Low levels of pricing controls limits pipeline of investible opportunities	High market fragmentation reduces pipeline of scalable opportunities
Current maturity of the technology	Low/Medium	High	High
Main govt support (current & planned)	R&D funding, project funding, revenue mechanism	Contracts for Difference, PPAs, pricing controls	Consumer grants, project funding for charging operators

Scarcity of opportunities   UK Pension constraints

Basis of preparation

The reader should be aware that this report, and the information contained within it, is prepared on the following basis:

- The preparation of this report requires the application of a number of key judgements and also requires assumptions and best estimates to be made at a given point in time. There is a risk that the judgement exercised, or the estimates or assumptions used may subsequently turn out to be incorrect. These judgements and resulting data presented in this report are not a substitute for judgements and analysis made independently by the reader;

- These judgements, assumptions and estimates are highly likely to change over time and, when coupled with the longer time frames used in these disclosures, make any assessment of materiality inherently uncertain. In addition, the Group's climate risk analysis and net zero transition planning will continue to evolve and the data underlying the Group's analysis and strategy remain subject to change over time;

- This report uses climate models, external climate data and other sources/ methodologies, each of which are subject to ongoing refinement and modifications beyond our control;

- The outputs of these models, external data and other sources/ methodologies can be materially affected by the quality of the underlying data used. They may be subject to uncertainties affecting the accuracy of their outputs. There is a risk that the outputs may be misinterpreted or misused when dealing with developing themes, such as climate-related disclosures and other environmental, social and governance data points, due to the lack of market standards, historical reference points and benchmark data, as well as the inability to rely on historical data as a strong indicator of future trajectories, in the case of climate change and its evolution;

- In general, the quality of the data relied upon in climate and ESG reporting is often not yet of the same standard as more traditional financial reporting and therefore presents an inherent limitation. Further development of reporting standards could materially impact the performance metrics, data points and targets contained in this report; and

- As standards, frameworks and practices continue to evolve, it may mean subsequent reports do not allow a reader to compare performance metrics, data points or targets from one reporting period to another, on a direct like-by-like basis.

Forward looking statements

This Report contains, and the Group may make other statements (verbal or otherwise) containing, forward looking statements and other financial and/or statistical data about the Group's current plans, goals and expectations relating to future financial conditions, performance, results, strategy and/or objectives. Statements containing the words: 'believes', 'budget', 'forecast', 'intends', 'will', 'may', 'should', 'expects', 'plans', 'aims', 'seeks', 'targets', 'predict', 'outlook', 'goal', 'continues', 'projected', and 'anticipates' or other words of similar meaning are forward-looking.

Such forward looking statements and other financial and/or statistical data involve risk and uncertainty because they relate to future events and circumstances that are beyond the Group's control.

Forward looking statements may be affected by:

- changes in legislation;
- industry and regulatory standards;
- the development of standards and interpretations including evolving practices in ESG and climate reporting with regard to the interpretation and application of accounting;
- climate change and a transition to a low-carbon economy (including the risk that the Group may not achieve its targets);
- the limitation of climate scenario analysis and the model that analyse them;
- lack of transparency and comparability of climate-related forward-looking methodologies;
- environmental, social and geopolitical risks;
- the Group's commitment to continue to deliver good customer outcomes; and
- the Group's ability with government and other stakeholders to manage and mitigate the impacts of climate change effectively.

As a result, the Group's actual future financial condition, performance and results may differ materially from the plans, goals and expectations set out in the forward-looking statements and other financial and/or statistical data within this Report. No representation is made that any of these statements will come to pass or that any future results will be achieved. As a result, you are cautioned not to place undue reliance on such forward-looking statements contained in this Report.

By their nature, forward-looking statements involve risk and uncertainty because they relate to future events and circumstances. The forward-looking statements speak only as the date on which they are made. The Group undertakes no obligation to publicly update or revise any of the forward-looking statements or data contained within this Report or any other forward-looking statements or data it may make or publish whether as a result of new information or for any other reason.

Endnotes

[1] Recommendations of the Taskforce on Nature-related Financial Disclosures

[2] "Climate Finance Markets and the Real Economy," Global Financial Markets Association and BCG (December 2020), adjusted for 2023-35 and "Climate Finance Funding Flows and Opportunities: What Gets Measured Gets Financed," The Rockefeller Foundation and BCG (November 2022)

[3] "Paris Agreement," UN Framework Convention on Climate Change (UNFCC)

[4] "Climate Change 2022: Impacts, Adaptation and Vulnerability," Intergovernmental Panel on Climate Change or IPCC (2022)

[5] Climate adaptation (e.g. natural disaster management) is an important activity. However, in this report we will focus just on climate mitigation since "climate adaptation" is still maturing and harder to quantify at this stage.

[6] In line with usage of the term "climate solutions" in the NZAOA's Target Setting Protocol, Third Edition (2023)

[7] "Climate Finance Markets and the Real Economy," Global Financial Markets Association and BCG (2020), adjusted for 2023-35.

[8] As reported on the NZAOA's website (2023)

[9] As reported on IIGCC's website (2023)

[10] "Written evidence from the Association of British Insurers (ABI) PSC0008," submitted to the UK Parliament on June 2021, https://committees.parliament.uk/writtenevidence/36961/pdf/

[11] As reported on the UN PRI's website, since signing the PRI allows organisation to publicly demonstrate its commitment to including environmental, social and governance (ESG) factors in investment decision-making and ownership.

[12] "Inaugural Net-Zero Transition Plan," Allianz (September 2023)

[13] This is a core part of a strategy that the UK Climate Change Committee has called the "Balanced Pathway" in the Sixth Carbon Budget (2020)

[14] This is part of the UK government's plan to enhance the country's energy security, seize the economic opportunities of the transition, and deliver the UK's net zero commitments, published by the Department for Energy Security and Net Zero (DESNZ, 2).

[15] This estimate is a measurement of invested stock as of December 2022. This estimate is consistent with NZAOA's Third Progress Report (2023) and Morningstar's SFDR Article 8 and 9 Funds: Q2 2023 in Review report. For more details, see Appendix.

[16] "How Rishi Sunak plans to free Britain from energy bureaucracy," The Telegraph (September 2023)

[17] LGPS Advisory Board (2023)

[18] Launched by HM Treasury in July 2023

[19] Includes, but is not limited to, net zero investment roadmaps for offshore wind, hydrogen, CCUS and heat pumps published by DESNZ in 2023.

[20] "Great British Nuclear: Overview," Great British Nuclear (2023)

[21] "A Legal Framework of Impact," PRI (2021)

[22] In final stages of writing by the Financial Conduct Authority at the time of this report's publication; to be adopted under UK law by 2024 or 2025. These SDRs endorse the global corporate reporting baseline of IFRS Sustainability Disclosure Standards issued by the International Sustainability Standards Board (ISSB).

[23] "The Transition Plan Taskforce Disclosure Framework," Transition Plan Taskforce (November 2022)

[24] "GTAG: Advice on the development of a UK Green Taxonomy," Green Technical Advisory Group (October 2022)

[25] "Investing in our future, Practical solutions for the UK government to mobilise private investment for economic, environmental and social policy priorities," London School of Economics (October 2023)

[26] Introduced by DESNZ in 2023

[27] "Investing in our future, Practical solutions for the UK government to mobilise private investment for economic, environmental and social policy priorities," London School of Economics (October 2023)

[28] "Chancellor's Mansion House Reforms to boost typical pension by over £1000 a year," HM Treasury (July 2023), https://www.gov.uk/government/news/chancellors-mansion-house-reforms-to-boost-typical-pension-by-over-1000-a-year

[29] Offshore Wind Net Zero Investment Roadmap," Department for Energy Security and Net Zero (March 2023), https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1167856/offshore-wind-investment-roadmap.pdf

[30] Examples include NZAOA's Target Setting Protocol, Third Edition (2023) and IIGCC's Net Zero Investment Framework: IIGCC's Supplementary Guidance on Target Setting (2021)

[31] "Climate Finance Funding Flows and Opportunities: What Gets Measured Gets Financed," The Rockefeller Center and BCG, (November 2022); "Climate Finance Markets and the Real Economy," Global Financial Markets Association and BCG (December 2020)

[32] "Developing countries are key to climate action," Brookings (March 2023), https://www.brookings.edu/articles/developing-countries-are-key-to-climate-action/#:~:text=Developing%20countries%20will%20be%20the,emissions%20as%20early%20as%202030

[33] Current split of investment is not necessarily indicative of future split

[34] "Superannuation Statistics," Association of Superannuation Funds of Australia (September 2023), https://www.superannuation.asn.au/ArticleDocuments/269/SuperStats_September23.pdf.aspx?Embed=Y

[35] Based on data from ASFA, IFM Investors via UK Prime Minister's Office and Aware Super (2023)

Call out box in page 13:

[1] "The Just Transition: Shaping the Delivery of the Inevitable Policy Response," Nick Robins (April 2022), https://www.unpri.org/download?ac=16124

[2] "Finance for Impact Summit" (July 2022), https://www.theglobalcity.uk/finance-for-impact

[3] "Just Transition Criteria – a practical tool for fund managers," Impact Investing Institute (May 2023), https://www.impactinvest.org.uk/resources/publications/just-transition-criteria/

About

Phoenix

Phoenix Group are the UK's largest long-term savings and retirement business.

With approximately £270 billion of assets under administration, Phoenix Group offers its c.12 million customers a range of products through our trusted pensions, savings and life insurance brands.

Phoenix Group's mission to help everyone achieve the retirement they want and stay with them for the whole journey.

Make My Money Matter

Make My Money Matter is a people-powered campaign founded by acclaimed filmmaker and activist Richard Curtis.

The campaign group aims to give citizens more voice and choice over their money so that their pension, investments, and bank aligns with their values, and builds a better world.

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