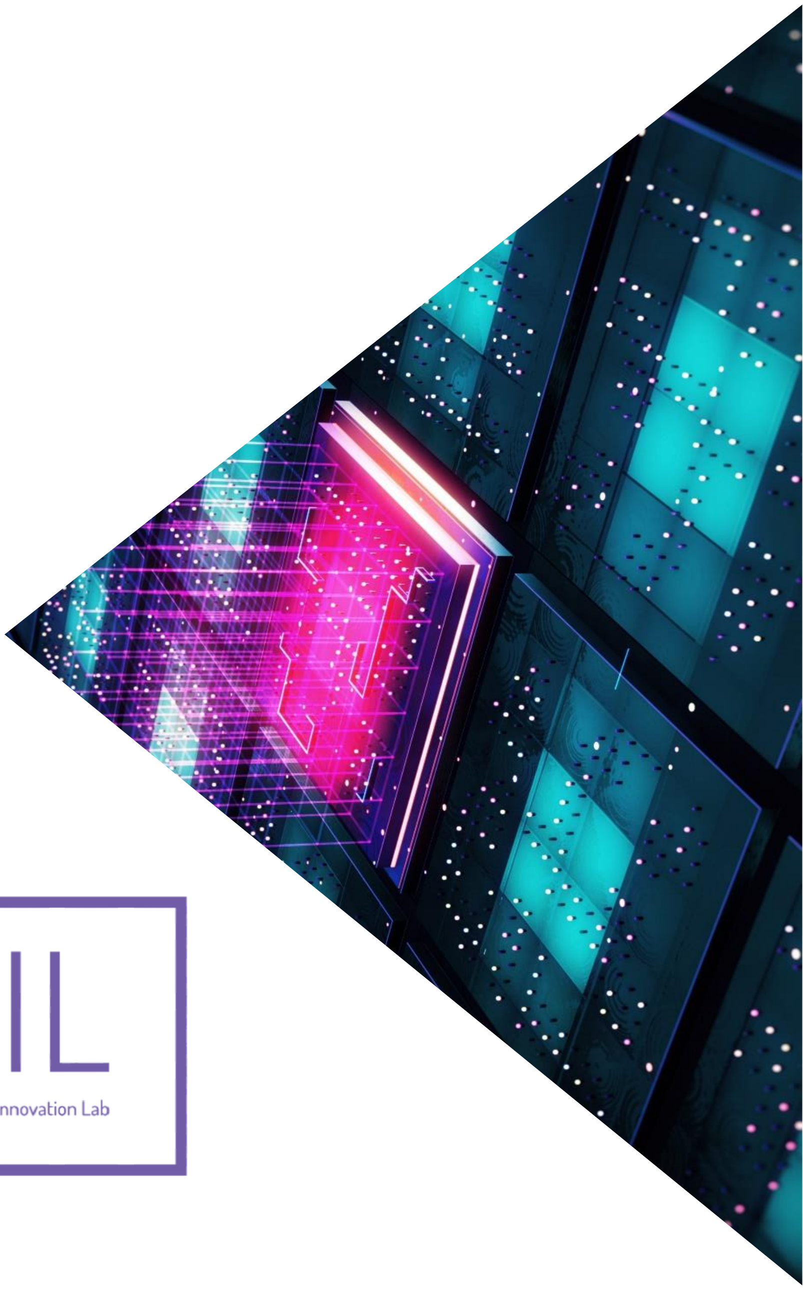
ISSN: 3033-4136

DOI: https://doi.org/10.36399/gla.pubs.351603

Sustainable Financial Products and UK Pension Schemes



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We acknowledge funding from Innovate UK, award number 10055559.

Many thanks to John Finch for comments on earlier drafts.

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Sustainable Financial Products and UK Pensions Schemes

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March 2025

Abstract: Sustainable financial products have gained significant traction in the financial world as climate change and social responsibility concerns continue to dominate public discourse. In the UK, Environmental, Social, and Governance (ESG) and sustainability considerations have been steadily gaining attention as both financial product designs and risk management tools. Economic trends, regulations, and soft laws have been reactive over the last decade to growing transparency and demands for accountability (Palea, 2022[1]; Escrig-Olmedo, Muñoz-Torres, Fernandez-Izquierdo, 2013[2]).

This paper explores the growing role of sustainable financial products in the UK's Defined Contribution (DC) pension schemes. It highlights key challenges and opportunities, focusing on the interplay between sustainable investment products, pension dashboards, Fintech, and institutional perspectives.

[1] Palea, V. (2022). Accounting for sustainable finance: does fair value measurement fit for long-term equity investments? *Meditari Accountancy Research*, *30*(1), 22–38. https://doi.org/10.1108/MEDAR-07-2020-0965

[2]Escrig-Olmedo, E., Muñoz-Torres, M. J., & Fernández-Izquierdo, M. Á. (2013). Sustainable development and the financial system: Society's perceptions about socially responsible investing. *Business Strategy and the Environment*, *22*(6), 410–428. https://doi.org/10.1002/bse.1755

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1 Introduction: The Shift Towards Sustainable Finance in Pensions

Pension schemes in the UK are traditionally structured around a focus on delivering financial security to members, ensuring that pensions are sustainable, affordable, and provide adequate returns. There has been a rising interest in integrating ESG factors into pension investments, coinciding with growing demand for Socially Responsible Investment (SRI) and Responsible Investing (RI), motivated by the growing demand from stakeholders for more sustainable investment choices, particularly as issues such as climate change, resource depletion, and social inequality gain urgency (Woods & Urwin, 2010[3]).With increased calls for transparent and accountable sustainable financial products, pension schemes seem like a natural fit as they are long-term, stable investments with consistent cash flows and calculable payments (European Insurance and Occupational Pensions Authority, 2024[4]). While there are significant opportunities for investment in sustainable financial products, there are also questions that arise around fiduciary duty, current and anticipated regulations, and the role of technology.

The UK's introduction of both the Pensions Dashboard and the Value for Money Framework significantly impact the current landscape of pensions investment practices, as they deliberately target enhanced transparency and accountable governance. However, beyond simply making pensions more transparent, both could also serve as tools to promote more sustainable pension options, particularly by encouraging active individual engagement and long-term investment practices.

1.1 Defined Contribution Pension Schemes and Defaults

There are two primary pensions scheme structures in the UK; Defined Contribution (DC) and Defined Benefit (DB). In a DC, the overall value is defined by the contributions made by the individual and the employer, whereas DB schemes are more often defined by the individual's salary and length of company service (UK Government, n.d.[5]). Since the 1980's, the UK has been gradually shifting more toward DC pensions, driven by corporates reacting to changes in accounting practices that required pension liabilities associated with DB schemes to be reported on balance sheets (causing volatility in net assets and associated metrics) and responding to demand for more direct control by individuals[6] (Josiah, Gough, Haslam, & Shah, 2014). Critics of the transformation in the pensions market typically highlight the exacerbation of economic inequality, as individuals with lower annual incomes may be less able to contribute more to

[3] Woods, C., & Urwin, R. (2010). Putting sustainable investing into practice: A governance framework for pension funds. *Journal of Business Ethics*, *92*(SUPPL 1), 1–19. https://doi.org/10.1007/s10551-010-0631-x

[4] European Insurance and Occupational Pensions Authority. (2024, June 4). *ESAs call for enhanced supervision and improved market practice on sustainability-related claims*. Https://Www.Eiopa.Europa.Eu/Esas-Call-Enhanced-Supervision-and-Improved-Market-Practice-Sustainability-Related-Claims-2024-06-04_en.

[5] UK Government. (n.d.). *Types of Private Pensions*. Https://Www.Gov.Uk/Pension-Types.

[6] Josiah, J., Gough, O., Haslam, J., & Shah, N. (2014). Corporate reporting implication in migrating from defined benefit to defined contribution pension schemes: A focus on the UK. *Accounting Forum*, *38*(1), 18–37. https://doi.org/10.1016/j.accfor.2013.10.003

their individual pensions and may find themselves stuck in a cycle of economic struggle (Choi, Laibson, Madrian, & Metrick, 2002[7]).

If an individual is enrolled in a DC pension scheme but does not actively choose between available plans, they are enrolled in the default plan. Five pension schemes currently account for roughly ninety-five percent (95%) of automatic enrolment, while the overall number of individual DC master trusts has been steadily dropping[8]. This concentration of pension pots poses both an opportunity and a potential concern if these massive sums of money are invested in areas that negatively impact the environment or local communities.

Types of DC pensions	
Trust-based market	A pension scheme governed by a board of trustees who have a fiduciary duty towards scheme members. The board of trustees manage investments on the members behalf. This is regulated by the Pensions Regulator (TPR).
Contract-based market	A pension scheme governed by a provider and an independent governance committee (IGC) where a contract exists between the individual scheme member and the provider. This is regulated by the Financial Conduct Authority (FCA).
Definitions from UK Government Publication, **Trends in the Defined Contribution trust-based pensions market,** 22 November 2023[9]	

[7] Choi, J. J., Laibson, D., Madrian, B. C., & Metrick, A. (2002). Defined Contribution Pensions: Plan Rules, Participation Choices, and the Path of Least Resistance. In J. M. . Poterba (Ed.), *Tax policy and the economy. Vol. 16* (p. 224). MIT.

[9] UK Government, D. for W. & P. (2023, November 22). *Trends in the Defined Contribution trust-based pensions market*. Https://Www.Gov.Uk/Government/Publications/Trends-in-the-Defined-Contribution-Trust-Based-Pensions-Market/Trends-in-the-Defined-Contribution-Trust-Based-Pensions-Market.

Table 1 below represents the occupational trust-based pension provision in the UK. This data refers to micro and non-micro schemes.

	Defined benefit	Hybrid: mixed benefit*	Hybrid: dual-section	DC (trust)
Schemes	4,680	230	560	25,800
Total membership	5,803,750	1,481,630	4,018,400	27,152,730
Total active members	359,340	274,900	828,650	10,377,290

* = also known as true hybrid

Source: all figures from TPR's data based on scheme returns, 31 December 2023

1.2 Pensions – Standalone vs. Institutionally-Connected

The research distinguishes between standalone pension schemes like the USS (a hybrid scheme with DB and DC elements), government-connected schemes like the LGPS (Local Government Pension Scheme), and institutionally-adjacent schemes connected to financial institutions like **HSBC** and **NatWest**. These three categories have different levels of exposure to sustainable financial products:

• **Standalone Schemes (e.g., USS):** These schemes are traditionally conservative in nature but are beginning to explore green bonds and other sustainable investments. For example, in its 2022 TCFD Report, USS stated that "We are cautious in respect of climate change issues being detrimental to performance. This means that with respect to exposure to climate change, we prefer safer and lower risk options."[10] It was further clarified that this meant a trustee preference for safe options that are low risk and have either moderate financial or opportunity cost, or only have the option for moderate reward. That stance aligns with a conventional stance on fiduciary duty (prioritising financial return) in the USS approach to responsible investment.[11]

• **Government-Connected Schemes (e.g., LGPS):** These schemes have a fiduciary responsibility to manage public funds and have increasingly embraced ESG factors to reduce risks associated with climate change. LGPS Central Limited, the pooled assets of eight midlands LGPS funds, has a Net Zero Strategy for Financed Emissions, a Responsible Investment & Engagement Framework, and seeks to influence the wider market through the three-pronged approach of Selection, Stewardship, and Transparency & Disclosure

[10] See p22 of the report at https://www.uss.co.uk/how-we-invest/responsible-investment/archived-responsible-investment-material.
[11] See generally https://www.uss.co.uk/how-we-invest/responsible-investment.

(LGPS Central Limited, n.d.[12]). The wider £326bn LGPS market is also well poised to engage in place-based impact investing, with over half of LGPS funds holding positions in one of the five key sectors (housing, SME finance, clean energy, infrastructure, and regeneration) (Forster et al, 2021 [13]).

• **Institutionally-Connected Schemes (e.g., HSBC, NatWest):** These larger institutions are often ahead of the curve in integrating sustainability into their investment portfolios, especially in response to regulatory pressure and public demand. Opportunities for sustainable financial products, such as green bonds, have been linked to increased risk mitigation, long-term returns, and positive economic performance (PRI, 2024[14], Della Croce et al, 2011[15]).

2. Fiduciary Duty of UK Pension Schemes

Fiduciary Duty in this context refers to the duty of trustees and agents (such as fund managers) to act in the best interests of beneficiaries. This duty was traditionally understood to mean the prioritisation of the financial interests of beneficiaries, but the nature and timeline of sustainability risks has necessitated a re-evaluation of this approach, with a variety of techniques being deployed to pursue sustainable investing strategies. Some argue that to ignore ESG metrics is to expose an investment to increased risk, as ESG metrics incorporate material risks such as long-term impacts of climate change or detriments of poor governance practices. The counter argument posits that ESG issues can be only be taken into account in limited circumstances as fiduciary duty is often perceived as a mandate to maximize returns, regardless of any values-impacted financial data. Gosling and MacNeil approach this issue by assessing common "net zero aligned" investment strategies such as portfolio decarbonisation, tilting, active ownership, ESG integration, and impact investing by reference to considerations of fiduciary duty and real-world efficacy at combatting climate change. They find that the more likely a strategy is to deliver real-world change in carbon emissions, the more likely it is to give rise to fiduciary concerns. xii

As Wood and Urwin (2010) argue, mission clarity and investment beliefs are the two governance elements most impacting sustainable investment for pensions. Mission clarity defines the pension scheme's overall mission or goals, and must be clearly defined; for instance, if a pension's mission is only mandated with highest overall returns, then the incorporation of environmental or social factors may be perceived as immaterial. However, the pension's mission can be framed to include elements such as sustainable governance practices, mitigating

[12] LGPS Central Limited. (n.d.). *Responsible Investment*. Https://Www.Lgpscentral.Co.Uk/Responsible-Investment/.

[13] Forster, S., Hepworth, M., Stanworth, P., Waples, S., Smith, A., & Black, T. (2021). *Scaling Up Institutional Investment for Place-Based Impact*.

[14] PRI. (2024, April 11). *Progress and priorities: reviewing sustainability in key pension systems*. Https://Www.Unpri.Org/Private-Retirement-Systems-and-Sustainability/Progress-and-Priorities-Reviewing-Sustainability-in-Key-Pension-Systems/12285.Article#:~:Text=Because%20sustainability%20factors%20such%20as,Protect%20long%2Dterm%20value%20and.

[15] della Croce, R., Kaminker, C., & Stewart, F. (2011). *The Role of Pension Funds in Financing Green Growth Initiatives* (OECD Working Papers on Finance, Insurance and Private Pensions, Vol. 10). https://doi.org/10.1787/5kg58j1lwdjd-en

environmental harm, or adhering to values-led investment practices (i.e. aligning with environmental, social, or faith-based values). Investment beliefs, on the other hand, are the assumptions made about the investment world, such as the assumption that environmentally focused financial products are less valuable, offer lower returns, or that environmental elements are immaterial. From this standpoint, fiduciary duty in aligning financial and sustainability-focused returns is heavily impacted by internal factor valuations.

From a regulatory and legal standpoint, there are challenges to the incorporation of ESG or sustainability metrics in investment decisions that may shift with different political parties but have been in evolution for well over a decade. As Sandberg (2011[16]) notes in his review of the Freshfields report and subsequent analyses of the allowability of ESG to factor into fiduciary duty decisions, significant legal reform is still needed to establish the framework and acceptable integration of ESG elements into investment decisions. Schanzenbach and Sitkoff (2020[17]) advance this analysis by arguing that ESG investment decisions fall naturally under duties of prudence, and that incorporating material ESG elements is, in fact, permissible if it is of benefit by providing a risk-adjusted return and that the trustee's motivation for incorporating this factor is in the interest of direct benefit. The recent paper from the Financial Markets Law Committee in the UK takes this a step further by proposing a process-based approach to the incorporation of ESG into investment decision making (taking account of uncertainty and evolving scientific knowledge) that provides enhanced legal safeguards to trustees (MacNeil 2024[18]).Taken together these interventions indicate integration of ESG or sustainability criteria as requiring legal and regulatory clarification (especially with regard to impact investing where impact is prioritised over financial return), but not as being in opposition to maximizing profits or properly ensuring fiduciary duty.

Furthermore, to encourage environmental reporting the UK government placed the onus on pension schemes to report, having a top-down approach to ensuring wider self-assessment and reporting as pensions providers required asset managers and asset owners to report as service providers. In a report from July of 2024, TPR details how pension scheme trustees have "…a fiduciary duty to consider financially material risks and opportunities, including in relation to climate change" (TPR). While the majority of trustees meet the minimum reporting requirements, TPR notes that if a pension scheme is invested in pooled funds[19], the trustees had significantly more difficultly integrating ESG decisions.

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[16] Sandberg, J. (2011). Socially Responsible Investment and Fiduciary Duty: Putting the Freshfields Report into Perspective. *Journal of Business Ethics*, *101*(1), 143–162. https://doi.org/10.1007/s10551-010-0714-8

[17] Schanzenbach, M. M., & Sitkoff, R. H. (2020). *Reconciling Fiduciary Duty and Social Conscience: The Law and Economics of ESG Investing by a Trustee*. https://perma.cc/FDB4-B937.

[18]

[18] MacNeil, I (2024) ESG as a case-study in legal uncertainty, Butterworths Journal of International Banking and Financial Law, 39(6), pp. 406-409.

[19] **Pooled funds** are aggregated funds from different sources (hedge funds, pensions, exchange traded funds, etc) brought together with the intent to maximize investment outputs. While they benefit from access to larger investment opportunities, diversification, and lower trading costs per dollar invested, they also allow for easier obfuscation of held assets and more difficult analysis of ESG factors of all investments held in the pool.

2.1 Mansion House

July 10, 2023, Chancellor Jeremy Hunt delivered the Mansion House speech which introduced a series of reforms designed to support the UK financial services sector, with a focus on promoting returns for savers, supporting high-growth companies, and simplifying regulations to encourage global competitiveness. This had several key points impacting UK pension schemes:

1. An industry-led agreement committed Defined Contribution (DC) pension providers to allocating at least 5% of their default funds to unlisted equities by 2030.

2. Joint consultations with TPR and FCA have been launched to create a new Value for Money Framework for DC schemes.

3. The Department for Work and Pensions (DWP) and His Majesty's Treasury (HMT) will issue a joint call for evidence to further analysis of fiduciary duty with a focus on good saver outcomes.

4. Further consolidation is encouraged among smaller pension pots, and a consultation to accelerate the consolidation of Local Government Pension Scheme (LGPS) assets in England and Wales have been launched.

5. Efforts to simplify financial regulations include a statutory instrument designed to repeal nearly 100 pieces of retained EU laws such as the Long-Term Investment Fund Regulation and part of the Payment Accounts Regulations, while the FCA and Payment Systems Regulatory (PSR)[20] have been granted rulemaking authority to replace the EU regulations.

The long-term opportunity of investment in more sustainable financial products underscoring the net zero transition are typical illiquid, and one key theme of the Mansion House speech is increased flexibility. As Brian Denyer of abrdn stated, "…if we have schemes running on for longer and potentially derisking, then we could increase that equity investment, also in length and investment time horizons, which means that creates liquidity requirements in short term, and it could potentially feed greater investment in illiquid assets." (Rach, 2023[21]) This greater flexibility offers funds the opportunity to explore longer-term investments, which are pivotal for ESG or sustainability-aligned investments.

3. The Role of the Pensions Dashboard in Promoting Sustainable Financial Products

The Pensions Dashboard provides an innovative platform for UK pension holders to view all their pensions in one place. This technological advancement has the potential to greatly impact sustainable pension offerings, as it will increase transparency and offer individuals the ability to align investments with values more easily. As Lowe et al (2021[22]) highlight, standardization of projection approaches, transparency of information provision, and simplified projections of risk adjustments are key to ensuring a more

[20] The PSR is in the process of being integrated into the FCA and will no longer operate as a unique organization.

[21] Sonia Rach. (2023, September 6). *Mansion House speech will change investment role of DB funds*. Https://Www.Ftadviser.Com/Pensions/2023/09/06/Mansion-House-Speech-Will-Change-Investment-Role-of-Db-Funds/.

[22] Lowe, A., Bradley, G., Nicholson, A., Inglis, R., Balaam, A., Lawson, S., & Wasserman, S. (2021). The pensions dashboard: An actuarial perspective future pensions landscape working party. In *British Actuarial Journal* (Vol. 26). Cambridge University Press. https://doi.org/10.1017/S1357321720000239

accessible, beneficial Dashboard that is of most use to users.

3.1 Pension Dashboard Features:

1. Integration with ESG Metrics: The dashboard could integrate ESG data, allowing members to easily access information about the sustainability of their investments, aligning financial products with personal values. The challenge of this will be in the standardization of ESG metrics, for which the UK government may wish to partner with an organization such as LSEG's Refinitiv or to follow the EU's efforts to standardize ESG rating agency transparency. Accessible methodologies allow consumers to better understand what is being measured, how it is being weighted, and how this impacts the overall scoring and performance of the company.

2. Improved Member Engagement: By providing clearer, more detailed views of pension investments, it is possible to encourage members to opt into sustainable products, leveraging user-friendly interfaces and accessible data presentation. This will further drive increased transparency and accountability among financial services providers as stakeholders increasingly align their investments with their values.

3. Policy Influence: As pension dashboards evolve, they may also play a role in promoting policy reforms that facilitate more sustainable investment practices, as they will offer a means of monitoring demands for values-aligned investments and will aid in gauging consumer reactions to long-term investments. Furthermore, allowing stakeholders to see long-term projections of investments may ease concerns and bolster interest in sustainable investments.

As Fintech companies increasingly collaborate with pension funds, these advancements create opportunities for innovation, especially in areas where sustainability meets financial technology. This will only be more vital as demands for transparency, accountability, and standardization of data grow.

4. The Opportunities for Fintech in Sustainable Pensions

Financial technology has become a key enabler of innovation in the financial sector. When it comes to sustainable pensions, Fintechs can help bridge gaps between pension providers and consumers, offering solutions such as:

1. Sustainable Investment Platforms: By leveraging Fintech platforms, pension schemes can offer automated and customizable sustainable investment options tailored to the preferences of individuals. Fintechs may also play a role in monitoring for fraudulent activity, ensuring accessibility and accountability regarding investment product information, and may closely monitor external material factors.

2. Data Analytics: Fintechs can enhance ESG data transparency, allowing pension holders to make informed choices about their pension contributions, to make long-term strategic plans based on current and projected incomes or career breaks, or to better understand the pros and cons of long-term investments in particular financial products.

3. Consumer Awareness: Fintech solutions can also facilitate greater awareness and education about sustainable investing, helping members better understand the environmental and social impacts of their pension schemes.

Fintech companies present significant opportunities for pension schemes to integrate sustainability into their offerings while improving efficiency and member engagement. With the focus on increased flexibility highlighted in Chancellor Hunt's Mansion House speech, innovation and creativity will create opportunities for long-term investments.

Opportunity for AI in pensions

Rising engagement with AI in pensions schemes presents in two distinct avenues; first, investments in AI are expected to continue growing in the coming years, with projections reaching $15.7 trillion in economic growth by 2030 (PwC, 2024[23]), and second, with AI being a tool to support investors in financial decision making.

As per the Pensions and Lifetime Savings Association, “AI may fill some of the knowledge gaps, and there is potential for default decumulation solutions to provide savers who do not want (or do not feel equipped) to make a decision with a good retirement outcome” (2024, pg 5[24]).

Gavin Sharma, head of pensions technology and AI at PwC UK stated in June of 2024, “We’re already seeing AI being used in pension schemes to increase operational efficiency - from automating data processes to drafting scheme documentation. And in the near future we can also expect to see AI being used to personalise the member experience and to bring insights that enhance decision making.” (PwC, 2024)

4.1 FCA & TPR’s Perspective on ESG Integration in Pensions

The FCA[25] and TPR[26] are both primarily focused on ensuring that pension schemes deliver value for money and that individuals are protected against poor governance or corporate negligence. Currently, their emphasis is on ensuring that costs are transparent, and that pension schemes deliver value through low fees and efficient management. However, as the demand for ESG-adjacent products grows, there are opportunities to expand this framework to include environmental outputs and social responsibility metrics. For instance, the FCA could develop guidelines that encourage pension schemes to invest more in long-term sustainability, rather than focusing on short-term returns. This circles back to the discussion of fiduciary duty and the significance of ESG materiality in investment assessments, as ESG metrics steadily become more mainstream and more integrated into the analysis process.

4.2 SIPS and ISs

Statements of Investment Principles (SIPs) and Implementation Statements (ISs) play a crucial role in integrating ESG factors into DC pension schemes. SIPs set out the trustees’ policies on financially material ESG considerations, including climate change, ensuring investment strategies align with long-term sustainability goals. Trustees must review and update SIPs

[23] PwC. (2024, July 3). *PwC analysis shows little change in scheme funding levels - but how will AI change the pensions industry?* Https://Www.Pwc.Co.Uk/Press-Room/Press-Releases/Research-Commentary/2024/How-Will-Ai-Change-the-Pensions-Industry-.Html.

[24] Pensions and Lifetime Savings Association. (2024). *DC Scheme Guidance On Retirement Arrangements and Partnerships*.

[25] FCA. (n.d.). *About the FCA*. Https://Www.Fca.Org.Uk/About.

[26] TPR. (n.d.). *The Pensions Regulator l About Us*. Https://Www.Thepensionsregulator.Gov.Uk/En/about-Us.

regularly to reflect evolving ESG risks and opportunities. Implementation Statements (ISs) provide transparency by reporting how trustees have adhered to their SIPs, detailing engagement with asset managers and ESG-related voting activities. These disclosures help members understand how their pension investments contribute to responsible investing.

The UK regulatory framework now mandates that trustees consider ESG factors as part of their fiduciary duties, designed to reinforce accountability. Enhanced SIP and IS reporting strengthens governance, promotes sustainable investment practices, and encourages pension schemes to drive positive change in corporate behaviour. Ultimately, these measures support better long-term outcomes for both pension scheme members and society, both in long-term returns and in risk mitigation.

4.3 Value for Money Framework

In October of 2024, the FCA and TPR detailed the Value for Money Framework being jointly progressed[27], which will compare pensions schemes on public metrics including investment performance and service quality and will require poorly performing schemes to improve or transfer pensions to better performing schemes. "Focusing on value rather than costs will enable providers to invest in assets which could deliver greater long-term returns but have higher management costs, such as infrastructure or venture capital" (FCA, 2024 [28]).

A recurring argument in sustainable financial literature is the necessity of a long-term approach versus short-term (Caitlin Casey, n.d.. [29]). With the FCA and TPR deliberately shifting focus to long-term investments, they are creating opportunities for greater investment in sustainable financial products as these tend to require longer investment horizons for projects such as complex infrastructure development. The process of derisking an investment also shifts when looking at a longer time horizon, and this is an opportunity for ESG metrics to serve as risk mitigation tools in the analysis of factors such as long-term impacts of climate change, shifting social patterns which may leave areas struggling to find employees, or anticipated regulatory changes that will impact an industry.

5. Challenges and Barriers to Sustainable Financial Products in Pensions

The transition to sustainable financial products in pensions is not without its challenges. Some of the key obstacles identified through interviews and research include:

1. Regulatory Constraints: Pension trustees and asset managers must navigate regulatory environments that have historically focused on financial returns. Fiduciary duty, which requires trustees to act in the best financial

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[27] FCA. (2024, October 18). *CP24/16: The Value for Money Framework*. Https://Www.Fca.Org.Uk/Publications/Consultation-Papers/Cp24-16-Value-for-Money-Framework.

[28] FCA. (2024, August 8). *FCA progresses framework to drive long-term value for workplace pension savers*. Https://Www.Fca.Org.Uk/News/Press-Releases/Fca-Progresses-Framework-Drive-Long-Term-Value-Workplace-Pension-Savers.

[29] Caitlin Casey. (n.d.). *Short-Termism in Financial Markets*. Https://Unglobalcompact.Org/Take-Action/Action/Long-Term.

interests of members, can conflict with the long-term nature of sustainable investments.

2. Cost Considerations: Sustainable products, such as green bonds, often have higher upfront costs, which may deter some pension schemes from integrating them into their portfolios.

3. Member Education and Engagement: While demand for ESG investments is rising, there is still a significant lack of understanding and engagement from pension scheme members regarding the long-term benefits of sustainable finance (Aristei & Gallo, 2021 [30]). There is, overall, a lack of active engagement from individuals, leading to most being automatically registered in a default scheme with little individual oversight.

4. Greenwashing and Greenhushing: As greenwashing concerns have led to increased transparency and accountability, the exposure of misaligned funds and investments has impacted consumer faith in the relatively new green and sustainable investment markets **(**Yu, Luu, & Chen, 2020[31], Carbon Tracker Initiative, 2023, May 5[32]).

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[30] Aristei, D., & Gallo, M. (2021). Financial knowledge, confidence, and sustainable financial behavior. *Sustainability (Switzerland)*, *13*(19). https://doi.org/10.3390/su131910926

[31] Yu, E. P. yi, Luu, B. van, & Chen, C. H. (2020). Greenwashing in environmental, social and governance disclosures. *Research in International Business and Finance*, *52*. https://doi.org/10.1016/j.ribaf.2020.101192

[32] Carbon Tracker Initiative. (2023, May 5). *Asset managers invest $400bn in oil & gas despite climate commitments*. Https://Carbontracker.Org/Asset-Managers-Invest-400bn-in-Oil-Gas-despite-Climate-Commitments/.

6. The Future of Sustainable Financial Products in Pensions

The growing demand for sustainable investment products is set to shape the future of UK pension schemes. Key developments to watch include:

1. Standardization of ESG Metrics: As more pension schemes adopt ESG criteria, there will be a push towards standardizing ESG measurement and reporting practices. This has already begun in the European Union, as the Regulation on ESG Ratings Activities (European Council, 2024, [33], European Parliament, [2024 34)] will lead to significantly more transparency amongst ESG ratings agencies, disclosure of methodologies and control over conflicts of interest.

2. Technological Innovation: The continued evolution of the Pensions Dashboard and Fintech platforms will allow pension schemes to offer greater transparency and ease of access to sustainable products.

3. Government and Regulatory Support: It is likely that regulatory bodies will introduce further guidelines to encourage the integration of ESG factors, especially as public concern over climate change intensifies and the materiality of ESG issues become more mainstream. Note, for example, the European Union focus on ESG Double Materiality (European Commission l Newsroom, 2022[35]).

7. Conclusion

The role of sustainable financial products in UK Direct Contribution pension schemes is evolving rapidly, driven by regulatory changes, technological advancements, and increasing consumer demand for responsible investment options. As pension schemes continue to integrate ESG factors into their portfolios, there are opportunities for both pension providers and Fintechs to drive innovation. However, challenges remain, particularly around fiduciary duty, regulatory constraints, and member education. By navigating these complexities and leveraging tools like the Pensions Dashboard, pension schemes can align financial returns with environmental and social responsibility, ensuring a more sustainable future for pension holders.

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[33] European Council. (2024, November 19). *Environmental, social and governance (ESG) ratings: Council greenlights new regulation*. Https://Www.Consilium.Europa.Eu/En/Press/Press-Releases/2024/11/19/Environmental-Social-and-Governance-Esg-Ratings-Council-Greenlights-New-Regulation/#:~:Text=The%20Council%20today%20adopted%20a,Confidence%20in%20sustainable%20financial%20products.

[34] The European Parliament. (2024). *Regulation (EU) 2024 /...on the transparency and integrity of Environmental, Social, and Governance (ESG) rating activities, and amending Regulations (EU) 2019/2088 and (EU) 2023/2859*. http://data.europa.eu/eli/C/2024/883/oj.

[35] European Commission l Newsroom. (2022, July 26). *Sustainable Finance*. Https://Ec.Europa.Eu/Newsroom/Fisma/Items/754701/En.

ABOUT THE AUTHORS

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