



# Unlocking Investment in Climate Solutions

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# 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,<sup>2</sup> 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.

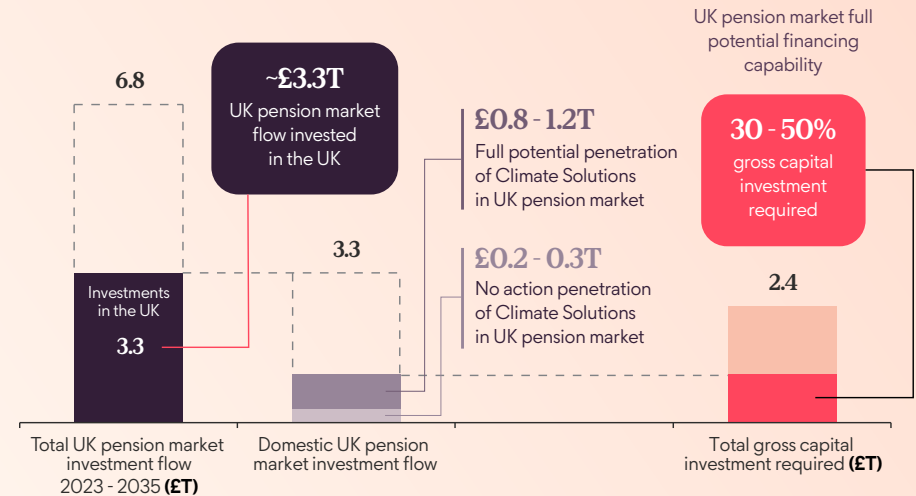
## Greater investment is currently limited by a scarcity of scalable opportunities and regulatory constraints

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

**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; Bloomberg; PitchBook; IEA; Preqin; Refinitiv; Pension Providers Interviews

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.

## 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 on 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:

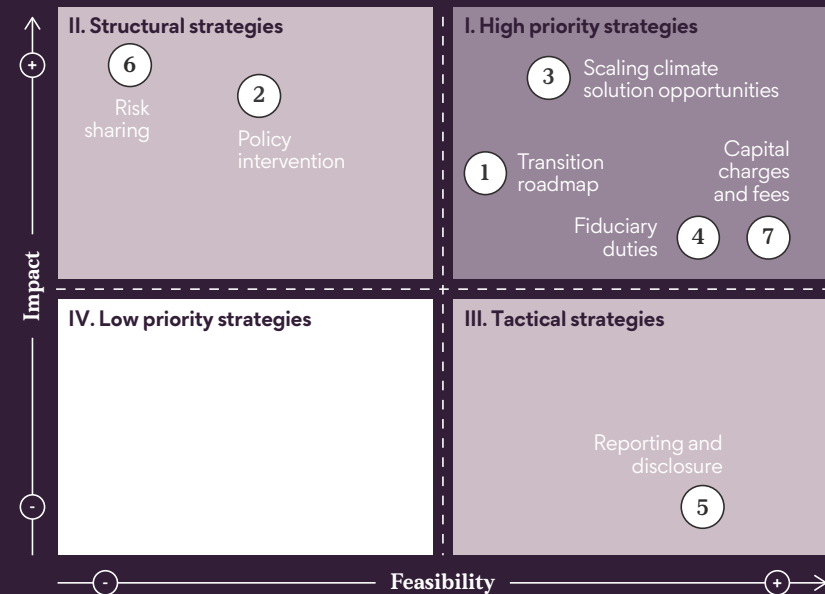
Accelerating ongoing regulatory consultations – with the expectation that the capital freed up for investment would be targeted at productive and sustainable finance, including climate solutions –

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.



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