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Rt Hon Mel Stride MP
Chair, Treasury Select Committee
House of Commons
London
SW1A 0AA

23 November 2020

Dear Mr Stride

Thank you for meeting with Julian Adams, Seth Williams and me last week – much appreciated. As promised, I will be back in touch in Q1 2021 when we have an updated claims payment estimate following the conclusion of the Supreme Court case on Business Interruption.

In the meantime, I writing to you to provide further additional commentary to the remarks I made in relation to ESG investments and Auto-Enrolment when giving evidence to the Treasury Select Committee on 14 October, as part of the Committee's Inquiry into Decarbonisation and Green Finance.

At the Committee session, members asked about ESG funds and consumer choice and I flagged the challenges posed by the charge cap of 0.75% for Auto-Enrolled schemes when most ESG funds are actively managed and therefore typically more expensive. This is a big issue; for the majority of ESG funds today approximately 81% of ESG assets overseen by European ESG funds are actively managed[1]. Sustainable investment funds listed on financial research website Morningstar, and those available to retail investors via investment platforms, are nearly **all** above the automatic enrolment charge cap[2].

However, in the interests of fairness and a fuller answer than was possible on the day, I should also note that it is possible to have some ESG components within Auto-Enrolment default funds and this seems to be growing. Institutional investors often have greater buying power than retail investors, meaning they can access some funds at a reduced fee, and incorporate these funds into their default funds. Many of our member firms have already integrated ESG considerations into their AE default fund or are in the process of doing so. Savers in many AE schemes and other pensions can also actively choose ESG-specific funds as part of the suite of funds available to pension savers. The number of passive ESG funds is rising (from a low base) and this has the potential to change the balance in the market between active and passive ESG funds over the next five years.

However, this is an emerging picture so I would like to re-emphasise the importance of the charge cap for automatic enrolment default funds not being lowered and that its scope

[1] https://www.institutionalinvestor.com/article/b1nlkhzs80xh42/Active-Funds-Dominate-ESG-But-Their-Market-Share-Is-Slipping#:~:text=Eighty%2Done%20percent%20of%20assets,68%20percent%20for%20the%20U.S.&text=ETFs%20and%20passive%20funds%20are,invest%20in%20ESG%2C%20Alexeyev%20said.
[2] https://www.morningstar.co.uk/uk/funds/esg.aspx

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is not extended. This summer the Department for Work and Pensions (DWP) undertook a review of the charge cap for automatic enrolment default funds. The charge cap is currently 0.75%, and is applied to the administration fees of the fund.

In its review, the government proposed reviewing alternative costs that could be included in the cap, and said that they wanted to "*assess the effectiveness of any measures designed to improve disclosure of transaction costs before deciding whether a cap on these costs would be appropriate, and if so, at which level it should be set*[3]". If the Government is committed to stimulating investment in illiquids or ESG products we believe it would be hard to include transaction costs within the charge cap, or to reduce the cap, as these products tend to carry more costs than ordinary investments, often outside a provider's control. We are looking forward to the DWP setting out its findings to the review by the end of 2020.

Finally, it is worth noting that the increased prevalence of ESG funds also presents additional challenge for the market in assessing quality. Good quality data is needed, with a consistent taxonomy and disclosure across the market and across the economy. We welcomed the Chancellor's announcement on 9 November providing clarity about the extent and timing of TCFD requirements.

I hope this is helpful. I would like to reiterate that the ABI and our members remain committed to working with the TSC, the UK Parliament and UK Government to explore policy solutions that meet the needs of savers whilst also tackling climate change.

Best wishes

Huw Evans

Huw Evans
Director General

[3] https://www.gov.uk/government/consultations/review-of-the-default-fund-charge-cap-and-standardised-cost-disclosure/review-of-the-default-fund-charge-cap-and-standardised-cost-disclosure#chapter-1-the-charge-cap