

Summary

- ESG is a (relatively) recent term for an old approach to values-driven investment.
- Within pensions, regulatory changes and a general increase in understanding have pushed ESG to the centre of investment strategies.
- ESG is in constant evolution and stewardship now takes the place of exclusionary tactics.
- Fiduciary duties and ESG approaches often go hand in hand – investing sustainably makes sense in financial terms as well as environmental or ethical terms.
- A US pushback against climate- and DEI-related policies has raised questions about ESG's future.
- Risk management and long-term thinking still hold ESG at the heart of UK pensions investment.

It was more than 20 years ago, in 2004, that the UN first used the term environmental, social and governance (ESG), but the history of this investment ideology goes much further back, and funds have long been opting out of investments that run counter to their values. In 1971, investment took the form of protest with the launch of the Pax Fund in the US, which explicitly refused to invest in companies linked to the Vietnam War. In 1984, Friends Provident launched the UK's ethical unit trust, the Stewardship Fund.

ESG is today integral to pension schemes' decision-making processes, and with the urgency of the climate crisis, increasingly complex social and governance matters, and an unpredictable global geopolitical situation, it's also an area of constant change.

Evolution in action

"In the past decade, attitudes have shifted massively," says XPS Group

Embedding ESG into UK pension schemes

Sandra Haurant traces ESG's evolution from ethical niche to fiduciary imperative for pension schemes, arguing that despite political backlash, UK investors see it as core risk management rather than ideology

head of responsible investment, Alex Quant. "Widespread interest in ESG and sustainability has grown significantly since key milestones like the Paris Agreement and creation of the UN Sustainability Goals in 2015, supported by broad consensus recognition that ESG factors are financial material that grew in subsequent years."

Awareness of climate change and sustainability are now mainstream concerns, and the industry has moved to meet demand, says Mercer UK wealth strategy leader, Tess Page: "Where many trustees and investment committees once viewed ESG primarily as a values-driven or reputational concern, it is now increasingly recognised and supported by evolving regulatory guidance as an essential component of fulfilling fiduciary duties".

L&G global head of DC, Lesley-Ann Morgan, adds: "ESG has moved decisively from a niche consideration to a core expectation, particularly within DC defaults, where the vast majority embed ESG screens or tilts." Member preferences have helped drive the shift, says Morgan; L&G's research has shown that DC savers "increasingly see sustainability as part of long-term value, not an optional extra".

Regulatory requirements have also played a large part in the shift, says Quant. "For pension schemes, there were key regulatory updates in 2019 and 2020 with Statement of Investment Principles changes – requiring schemes to state whether they thought ESG was financially material – and the

introduction of Implementation Statements and taskforce on climate-related financial disclosures (TCFD) reporting requirements, all pushing ESG, climate change and stewardship up the trustee agenda," says Quant.

Changing times

However, the world looks quite different in 2026, and challenges in global markets and geopolitical relationships have kept the ESG story in motion. "It could be said that Covid shifted attention elsewhere, not necessarily because people didn't think that it was still important, but because you had a lot on your plate when managing investment decisions in a pension scheme after Covid," says Travers Smith senior counsel, pensions, Harriet Sayer. "Trying to manage the impact of inflation, and credit spreads, and then everything that is happening with AI and the Magnificent 7 [*the big tech companies, Alphabet, Amazon, Apple, Meta Platforms, Microsoft, Nvidia, and Tesla*], and the impact on valuations and CapEx spending. I think that shifted some of the focus and momentum away from ESG."

However, she adds: "I always say that ESG should sit within pension scheme priorities; it's a very useful set of tools for dealing with those issues."

Engaging for change

In the early days of ESG, funds would opt out of a list of so-called sin stocks from sectors which did not align with core values. Today, says Sayer: "There is

an increase in focus on stewardship, and how that can be material to achieving or maintaining or improving the balance of risk and return,” says Sayer.

The United Nations’ Principles for Responsible Investment defines stewardship as: “The use of investor rights and influence to protect and enhance overall long-term value for clients and beneficiaries, including the common economic, social and environmental assets on which their interests depend.” Stewardship involves an active relationship with investee companies, and, says Page: “This approach allows for a more granular evaluation of companies, reflecting the complexity of ESG issues.”

“ [ESG] is now increasingly recognised and supported by evolving regulatory guidance as an essential component of fulfilling fiduciary duties”

As a result, Morgan adds: “Companies are increasingly assessed on governance quality, credible climate pathways and their role in long term resilience, rather than by sector label alone.” At the same time, she says: “Companies that would fall within the conventional ESG sphere, such as climate transition technologies and sustainable infrastructure, are continuing to gain prominence.”

The greater good?

Pension schemes must, above all, adhere to their duties to members, and the good news is, says Page: “Balancing ESG obligations with fiduciary duties is clearer today than in the past. Financially material ESG factors are now explicitly recognised as part of trustees’ fiduciary responsibilities. Regulatory guidance from The Pensions Regulator, alongside statutory climate-related disclosure



requirements for larger schemes, has reinforced that managing long-term systemic risks – including climate change, biodiversity loss, social issues and governance failures – is consistent with acting in members’ best financial interests.”

And Morgan agrees: “The perceived tension between ESG considerations and fiduciary duty is a misnomer. The financial materiality of climate and sustainability risks is now well established, and we have a duty to protect our clients against these risks, making ESG considerations a core part of fiduciary duty, not something in conflict with it.”

The backlash fallacy

Recent policy decisions, particularly across the Atlantic, have led to questions about future developments for ESG investing. The Securities and Exchange Commission (SEC) voted to end its defence of rules on the disclosure of climate-related risks and greenhouse gas emissions; the SEC acting chairman Mark T. Uyeda called the rules “costly and unnecessarily intrusive”. The US administration has been enthusiastic about pushing fossil fuels, and the country’s withdrawal from the Paris Agreement took effect in January 2026.

Added to this, the US administration has made a concerted push against diversity, equity and inclusion (DEI) policies, a mainstay of the ‘G’ in ESG. Talk of a more generalised pushback against ESG has been in the headlines.

But according to Page: “The reality within the UK pensions industry is more nuanced than the headlines suggest,” she says. “ESG continues to be primarily framed through fiduciary duty and risk management. This means that there has been a limited impact upon investors’ integration of financially material ESG factors into their investment decision making and makes a future retreat unlikely.”

Quant adds: “I think ultimately European and UK investors have a stronger view that sustainability issues like climate change and other ESG risks are financial risks, and so they will continue to be taken into account. In fairness, I think that’s probably true of many US investors, but the issue has just become so highly politicised there, it’s hard for them to be vocal about that. Lots of large European/UK investors have set their own net-zero targets, and we’re not seeing them step back from those commitments.” Still, Quant says: “XPS carried out a poll last year of asset managers and the results showed of the 90 attendees who responded to a poll, over half (52.2 per cent) of fund managers expect the US pushback on ESG and climate change initiatives to spill over to European markets.”

Nonetheless, Morgan argues, the purely practical arguments for ESG still hold: “The splintering of sentiment we are seeing across different regions doesn’t take away the core issue of portfolios being exposed to financially material risks. [...] Industry analysis points to a period of recalibration rather than retreat, with a greater focus on evidence, clarity and realistic transition pathways.”

Written by Sandra Huarnt, a freelance journalist