

Investing in our future: delivering for savers and the economy

July 2023

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The UK insurance and long-term savings market and the ABI

*The Association of British Insurers is the voice of the UK's world-leading insurance and long-term savings industry. A productive and inclusive sector, our industry supports towns and cities across Britain in building back a balanced and innovative economy, employing over **350,000** individuals in high-skilled, lifelong careers, two-thirds of whom are outside of London.*

*Our members manage investments of **£1.6 trillion**, pay over **£17.2 billion** in taxes to the Government and support communities and businesses across the UK by enabling trade, risk-taking, investment and innovation.*

*Our industry is also a global success story, the largest sector in Europe and the fourth largest in the world. The ABI represents over **200** member companies, including most household names and specialist providers, giving peace of mind to customers across the UK.*

Executive Summary

- **Pension interventions must put savers first.** We strongly support initiatives to improve the UK's competitiveness to attract investor capital, and pensions are very relevant to this debate, as the UK is the 2nd largest pension market in the OECD¹. The litmus test for any new policies must be that they deliver better outcomes for savers, as pension money is intended to secure their standard of living in retirement.
- **Pension interventions must be appropriate for the starkly different parts of the pension landscape.** The UK's pension system divides into private sector defined benefit (DB) schemes, public sector DB schemes, both funded and unfunded, and defined contribution (DC) pension schemes. These are starkly different systems in terms of demography, generosity of employer contributions, and the long-term future of these schemes. These factors are crucial when considering the most appropriate investment for members of these schemes.
- **For DC schemes, we need to see an end to the current "cost is king" culture.** Ever since the advent of auto-enrolment, almost the entire public discourse on the quality of DC pensions has been about the annual management charge being levied on savers' funds, with "cheap is good" being the mantra. In a tender for an employer's pension scheme, schemes can now be won or lost by a difference of a single basis point. This crowds out and depresses the demand for illiquid investments.
- **We fully support the direction of DWP's and the regulators' Value for Money work.** This should take us to a more holistic assessment of pension schemes for their overall value proposition, including investment performance, quality of service, and price. If DC schemes are unable to demonstrate value for money to regulators, there should be swift and decisive action to force them to demonstrate how they will improve, and ultimately to wind them up and consolidate them if they don't.
- **Employee benefit consultants should be regulated for the advice they give to employers on pensions.** The Financial Conduct Authority (FCA) and the Competition and Markets Authority (CMA) previously recommended that investment consultants – often the same firms as employee benefit consultants – should be regulated by the FCA. This would ensure that all parts of the value chain are held to account for focusing on Value for Money rather than cost.
- **Ending "cost is king" needs to be coupled with further creative ideas to incentivise investment** like the Long-Term Investment For Technology and Science (LIFTS) initiative of the British Business Bank. The LIFTS initiative seeks to establish new funds to support the growth of the UK's most innovative science and technology companies and will have a government-funded commitment of up to £250 million as co-investment to support successful proposals. Initiatives like these will both boost supply of these investment opportunities and alter the risk/return calculus for schemes.
- **Regulation must make it as simple as possible to invest in illiquids.** For example, the new Long-Term Asset Funds (LTAFs) are a welcome development and some of our members have already launched them. But they have specific uses and restrictions in DC pensions, and they avoid the FCA's limits on what firms can invest in, known as permitted links. Firms may wish to make specific illiquid investments outside of LTAFs, including in the Government's proposed LIFTS scheme. The FCA should work with the industry to ensure the permitted links rules do not constrain firms from making these investments.

¹ <https://www.oecd.org/daf/fin/private-pensions/Pension-Markets-in-Focus-Preliminary-2021-Data-on-Pension-Funds.pdf>

- **Governments should not mandate that pension money is channeled into particular sectors of the economy.** This avoids both the real risk of asset bubbles, and shifting priorities from one administration to the next which sits uncomfortably with long-term investment. Trustees must remain sovereign in their decision making and continue to make investment decisions themselves, with appropriate investment advice.
- **A long-term strategy is desperately needed to increase savings rates in DC pensions.** In the private sector, DC pensions are the future, forecast to grow from £500 million now to £1 trillion by 2030. But contributions in DC, at 8% of a band of earnings, are still much too low to provide a comfortable retirement for large swathes of the UK working population. For comparison, the Australian superannuation rate is rising from 10.5% to 11% in July 2023, and to 12% in 2025. We have previously laid out plans² to gradually raise employer and employee contributions over the next ten years to 2032 and would like to see a long-term strategy taken forward on a cross-party basis. For a start, Government should press ahead with its plan to increase auto-enrolment contributions by removing the lower earnings limit and starting auto-enrolment at age 18 instead of 22.
- **For private sector DB schemes, insurers are the natural consolidators in a well-functioning and well-regulated market.** The vast majority of DB scheme members are retired or approaching retirement, and the vast majority of DB schemes are closed entirely or closed to new members. Insurers have consolidated £300 billion of DB employer liabilities already, guaranteeing full and inflation-uprated pension payments for 1.6 million people in the UK and their families. 75% of DB pension schemes are targeting buy-out, and the sector is projected to grow by £50 billion a year for the next decade. By 2030 half of all DB pension scheme liabilities will have been insured, covering 5 million members' benefits and close to £1 trillion of liabilities³. While capital rules (both Solvency 2 and Solvency UK) make investments in equities fairly unattractive, insurers invest pension monies directly into the fabric of UK society, funding vital infrastructure projects like the Thames Tideway Tunnel to prevent future sewage spills, Hornsea 1&2, the world's biggest offshore windfarms, and Wirral One, the UK's largest urban regeneration project. This generates the fixed payments that are needed to provide a secure income. If implemented appropriately, the new Solvency UK rules will enable insurers to invest even more in UK productive assets.
- **DB schemes with little or no prospect of achieving buy-out could be given access to The Pension Protection Fund's scale and investment capabilities,** provided that employers retain their obligations and full benefits are still paid. A more expansive role for the PPF as has been mooted elsewhere would be a major market intervention in a market where there is no market failure, through introducing a competing public provider. It would also risk undermining member security and introduce moral hazard of employers neglecting their schemes. Any new remit for the PPF would open up complex questions about who pays for the expanded role, whether there would be cross-subsidies with the PPF's existing compensation framework, and whether Government would take on the PPF's assets and liabilities, to name but a few.
- **Further consolidation is appropriate for the 86 Local Government Pension Scheme (LGPS).** The LGPS is the only UK pension scheme comparable in size to the large schemes overseas, with £369 billion in assets for the retirements of local authority workers. Like the overseas funds, it is also an open scheme, with new workers constantly joining the scheme. The part-consolidation achieved so far has not been bold enough – in fact, LGPS overheads have increased. We therefore support the proposals in Budget 2023 to speed up the pace and scale of LGPS pooling.

² <https://www.abi.org.uk/globalassets/files/publications/public/lts/2022/automatic-enrolment-what-will-the-next-decade-bring/>

³ DC figure es, [TPR blog](#) (2021); DB figures: Hymans Robertson, March 2023 - <https://www.pensionsage.com/pa/bulk-annuity-market-set-for-tidal-wave-of-demand.php>

Section 1: Pension arrangements and investments: current state of play

Key facts and figures

Money in DC pensions is expected to rise to **£1 trillion** by 2030 from over £500 billion in 2021.

Over **10 million** more people are saving into a pension because of automatic enrolment. But the low contributions in DC risk millions of people not having enough income in retirement.

In 2019 employers contributed **22.2% on average** into private sector DB schemes and **just 3.5%** on average in DC schemes. A factor of 6:1.

Insurers have consolidated £300 billion of employer pension liabilities already, guaranteeing full and inflation-uprated pension payments for around 1.6 million people in the UK and their families.

All other big public sector pensions are unfunded – they operate on a pay-as-you-go basis. The net public sector pension liabilities were estimated to be **£2.2 trillion** in 2019-2020.

DB schemes have £1.67 trillion in assets (PPF eligible, March 2022).

75% of DB schemes are now targeting insurer buyout, and around 40% of those expect to fully insure in the next five years, with half of all DB pension liabilities expected to be insured by 2030, covering five million members and close to a £1 trillion in assets.

There are 9.8 million people in private DB/hybrid schemes and 17.2 million in public ones.

The Local Government Pension Scheme (LGPS) is the only funded scheme for public sector employees i.e. contributions are paid to a fund which is invested and from which benefits are paid at retirement, and is forecast to increase to £500 billion in the next decade (March 2022: £369 billion).

Two thirds of total pension income tax relief went to DB pension contributions in 2018.

Insurers have multiple roles in UK pension investments:

1. Providing individual pensions and group personal pensions in accumulation, with 18 million policies and £550 billion assets under administration.
2. Providing occupational pension schemes including trust based, with 4 million schemes and £260 billion assets under administration.
3. Paying annuities, with 5.1 million annuities and £9.3 billion in payments annually.
4. Consolidating defined benefit schemes through bulk annuities – an estimated £300 billion to date.
5. Providing unit-linked funds, which, according to the FCA in 2019, accounted for approximately £1 trillion of assets across the market.

Different pension arrangements - like comparing apples and fish

1. The UK's pension system divides into defined benefit (DB) and defined contribution (DC) pensions, two starkly different systems in terms of demography, generosity of employer contributions, and the long-term future of these schemes. These factors are crucial when considering the most appropriate investment.
2. Those who are responsible for looking after people's pension money are regulated by different bodies. The Pensions Regulator (TPR) regulates the c.5,000 DB pension schemes and c.26,990 DC trust-based occupational pension schemes⁴. Around 95% of DC schemes (25,700) have fewer than 12 members, and 84% of those are 'relevant small schemes' or executive pension plans, which escape some regulations. The FCA regulates over 100 contract-based providers under an entirely different regime, and some of these are used for workplace pensions. The PRA regulates some of these firms, including all insurers, for prudential purposes.
3. Having different regulators means there are different rules for pension providers on what they can invest the money in. TPR and DWP have some principles-based guidance that covers investments, both of which could be enhanced to encourage trustees to make active and productive investments where this fits their objectives. The FCA governs what investments insurers can make on behalf of consumers, where the latter holds the risk, under the permitted links rules – an extremely complex piece of regulation that has seen some recent changes to facilitate long-term productive investments. The PRA sets capital requirements for insurers which have implications for the types of assets held.
4. This fragmentation is also evident in pension policymaking, with pensions policy sitting with the DWP, but fiscal pensions policy including the rules for accessing pensions being the responsibility of HM Treasury. The most significant pensions policy reform of the last decade – Pension Freedoms – was made by the Chancellor, not the Secretary of State for DWP.
5. Despite recent efforts by regulators to achieve a more joined-up approach, their rules often diverge, creating inefficiency in the pensions market.

Workplace pensions		Individual pensions	
<p><i>Trust-based (TPR regulated)</i></p> <ul style="list-style-type: none"> • DB single employer schemes • DC single and DC Master Trust employer schemes • Local Government Pension scheme • Unfunded public sector schemes 	<p><i>Contract-based (FCA regulated)</i></p> <ul style="list-style-type: none"> • Group personal pension schemes (DC) • Insurer “buyout” of DB scheme benefits 	<p><i>Pension Compensation Scheme for Failed Employers (with reduced benefits)</i></p> <ul style="list-style-type: none"> • Pension Protection Fund 	<p><i>Contract-based schemes (FCA regulated)</i></p> <ul style="list-style-type: none"> • Individual personal pensions (DC) • Individual purchased annuities (guaranteed income)

⁴ <https://www.thepensionsregulator.gov.uk/en/document-library/research-and-analysis/dc-trust-scheme-return-data-2022-2023>

How are pension assets spread over different arrangements?

DB vs DC schemes

6. DB schemes own the largest share of UK pension assets, because such schemes were the norm in the past and because they benefited from very generous employer contributions (22.2% in private sector DB schemes on average in 2019, compared with 3.5% in DC). DB arrangements in the private sector are very much in decline. There are a number of reasons for this, including legislative moves over the years to strengthen the security of members' benefits against the risk of employer insolvency, and accounting changes.
7. Now, only 9% of DB schemes in the private sector are still open to new entrants, and fewer than 800,000 people are still actively accruing benefits out of the total of 9.8 million scheme members. 40% of these active members are in just two schemes – the USS and Railpen – both of which already invest significantly in equities⁵. The vast majority of people with DB entitlements (outside of the public sector) are approaching retirement or already retired. By the end of this decade, half of DB pension scheme liabilities will have been insured, covering five million members' benefits and close to £1 trillion of liabilities⁶.
8. In contrast, DC pensions are broadly speaking the domain of the young in the private sector. Over the next 10 years, the balance of members will shift towards DC. Largely due to the success of automatic enrolment (AE), most money being actively saved into a UK workplace pension will be going into a DC arrangement. There are well over 10 million more people participating in workplace pension saving because of AE, reversing years of decline in private sector pension participation⁷.
9. By 2030, it is estimated that the DC market will have grown to £1 trillion⁸. While membership of DC schemes rapidly surpassed that of DB schemes, the transition from DB to DC in terms of assets will be long. One main reason for this is the historic and current chasm between employer contributions for DB (22.2% on average in private sector schemes in 2019) and DC (3.5% on average in 2019) schemes⁹. This is the key factor that is driving poorer outcomes for DC pension savers compared to DB savers, rather than asset allocation as is sometimes suggested.
10. Pension assets are different for most of those working in the public sector. The Local Government Pension Scheme (LGPS) is the only funded scheme for public sector employees, i.e., contributions are paid to a fund which is invested and from which benefits are paid at retirement. The LGPS is forecast to increase to £500 billion in the next decade (2022: £369 billion¹⁰). All other big public sector pensions are unfunded (operate on a pay-as-you-go basis). The net public sector pension liabilities were estimated to be £2.2 trillion in 2019-2020¹¹. Unlike other countries, the UK has no Sovereign Wealth Fund to pay for them.

⁵ <https://www.thepensionsregulator.gov.uk/en/document-library/research-and-analysis/db-pensions-landscape-2022>

⁶ <https://www.pensionsage.com/pa/bulk-annuity-market-set-for-tidal-wave-of-demand.php>

⁷ <https://www.gov.uk/government/news/ten-years-of-automatic-enrolment-achieves-over-114bn-pension-savings>

⁸ <https://blog.thepensionsregulator.gov.uk/2021/09/30/dc-investing-for-the-future/>

⁹ <https://www.pensionspolicyinstitute.org.uk/sponsor-research/pension-facts/>, Table 16 based on ONS, 2019

¹⁰ <https://lgpsboard.org/index.php/scheme-annual-report-2022>

¹¹ https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1080609/Whole_of_Government_Accounts_2019-20.pdf

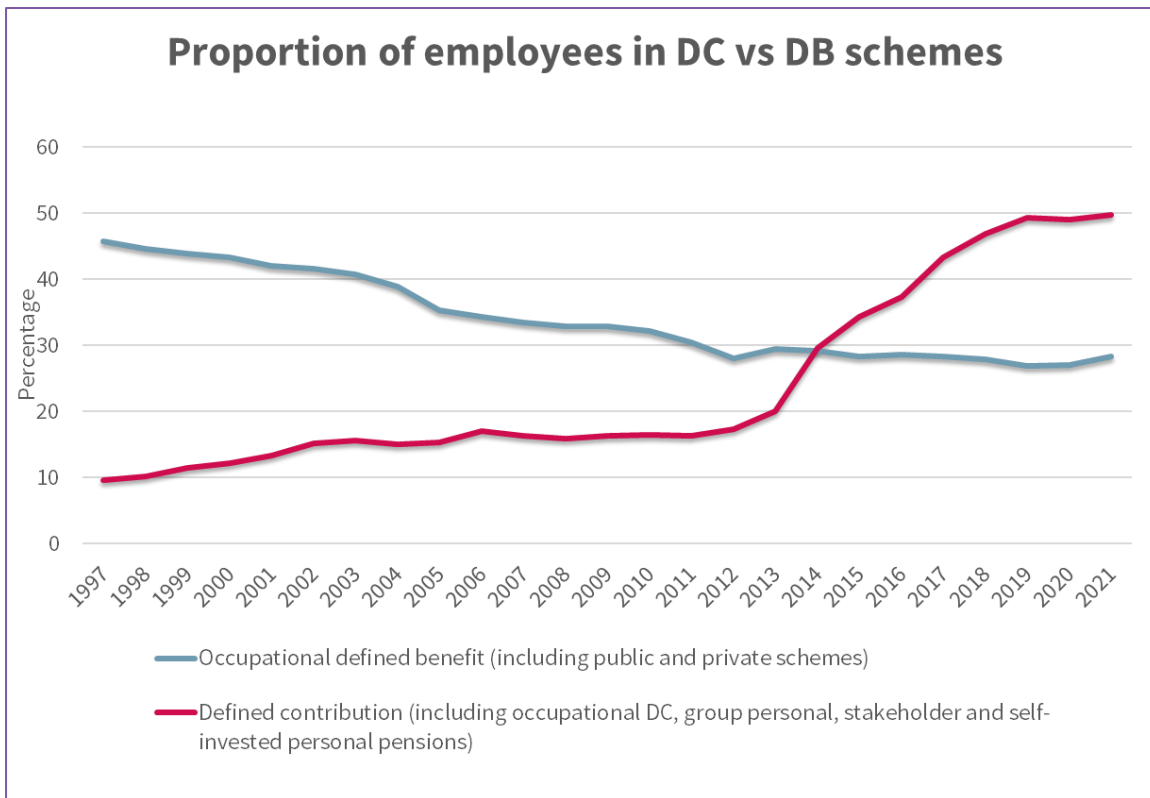


Figure 1: Percentage of employees in DC vs DB schemes over time (Source: ONS, 2021¹²)

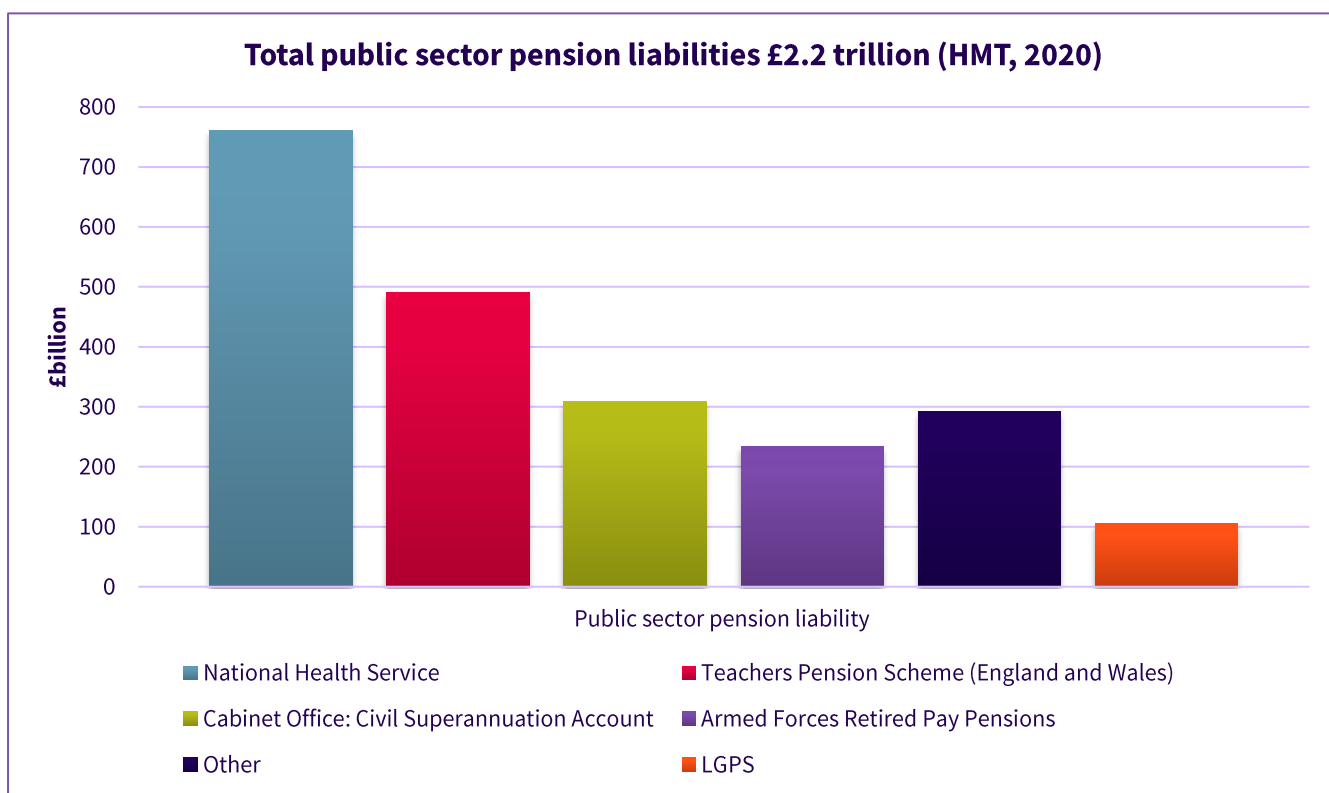


Figure 2: Total public sector pension liabilities (Source: UK Whole of Government Accounts, 2020¹³)

¹²<https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/workplacepensions/bulletins/annualsurveyofhoursandearningspensionables/2021provisionaland2020finalresults>

¹³https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1080609/Whole_of_Government_Accounts_2019-20.pdf

What are the underlying reasons for investing (or not) in different types of assets?

11. Much commentary on pensions and growth has centered on demand-side interventions to encourage particular types of investment by pension schemes. But it is fundamentally important to understand the reasons why firms invest in different assets, in the UK and elsewhere, so that supply-side issues are also understood and can be addressed.

Supply side matters

12. The UK overall is an attractive place for pension investment. It is a defensive market, with a strong presence in pharmaceuticals, energy and consumer staples companies. UK equity values have been resilient over the long term to inflation, and having UK assets is beneficial for UK investors due to currency matching with pension liabilities.
13. Pension capital flows internationally and the UK competes with other countries for capital: the UK is only 4% of the global market¹⁴. The American company Apple's market capitalisation is greater than all of the UK's listed companies combined¹⁵. Those looking to diversify their portfolios to meet their duties to savers will look to ensure their assets are spread over multiple global markets. It is important to note that the UK is not an outlier when it comes to investing elsewhere – in countries from Australia to Canada and the Netherlands, there has also been a decrease in pension schemes' domestic equity exposure¹⁶.
14. Significant global economic headwinds have set the context for the UK's economic performance in recent years, including the financial crisis of 2008, the exit from the single market, the pandemic and current shifts in inflation and interest rates. Business investment (10% of GDP in 2019) lags behind France, Germany and the USA (13% of GDP). Investment growth stalled after the Brexit referendum and has recovered slowly after the pandemic¹⁷. In this context, it is perhaps unsurprising that half of scale-up CEOs worry about whether the UK will be a good location for a business in a few years' time and six in ten think that it is harder to grow a business in the UK now than in the past.¹⁸ The Government is well aware of these challenges and is acting upon them, leading to the current exploration of ways to use the pension system.
15. The symptoms have also included a decline in UK Listings, which the Government and regulators are taking steps to address. The total capitalisation of London-listed equities fell from a high of \$4.3 trillion in 2007 to about \$3 trillion in May 2023¹⁹. Companies looking to go public will achieve better valuations for the same stock somewhere else. S&P 500 stocks trade at about 18 times expected earnings, whereas in the UK FTSE 100 it is only 10 times²⁰. So while purchasers of UK stock are getting relatively good value, and pension schemes may increase their UK holdings if they offer good returns, companies will still be more incentivised to list elsewhere.
16. The UK Government is already acting to reverse these trends. The Edinburgh reforms announced in December 2022 aim to stimulate growth and competitiveness in the UK and are welcome²¹. They recognise that UK financial services have an important role as world-leading sector that continues to attract global investment. The new Solvency UK rules, if implemented appropriately, will enable insurers to invest even more in UK

¹⁴ <https://www.cnn.com/2023/05/10/apple-vs-the-world-apples-bigger-than-entire-overseas-stock-markets.html>

¹⁵ <https://www.cnn.com/2023/05/10/apple-vs-the-world-apples-bigger-than-entire-overseas-stock-markets.html>

¹⁶ https://www.thinkingaheadinstitute.org/content/uploads/2022/02/GPAS_2022.pdf, p. 35.

¹⁷ <https://economy2030.resolutionfoundation.org/reports/stagnation-nation/>, p16

¹⁸ <https://www.scaleupinstitute.org.uk/scaleup-review-2022/annual-review-highlights/>, p7

¹⁹ <https://www.bloomberg.com/news/articles/2023-04-19/why-the-london-stock-exchange-lost-two-thirds-of-its-activity>

²⁰ Refinitiv, 2023

²¹ <https://www.gov.uk/government/collections/financial-services-the-edinburgh-reforms>

productive assets. Similarly, recent proposals to boost foreign direct investment seek to compete with the USA's Inflation Reduction Act and the EU's Green Plan. These changes need to be part of a wider Government plan to make the UK more investible. Making the UK a more attractive place to invest overall will lead to greater allocation of investment capital, including from pensions, in infrastructure and other private assets. UK pensions have an important role to play as investors, but they alone will not be able to fill the gap in the short term.

How regulation shapes pension investment

There are multiple regulatory reasons for schemes investing the way they do.

- **The fiduciary duty** of trustees obliges them to invest in scheme members' collective best interests. Trustees must take ESG considerations into account and are allowed to take non-financial considerations into account. They may consider best interests over a shorter or longer-term horizon.
- The FCA's **new Consumer Duty**, which applies from 31 July 2023, obliges firms to ensure that their products provide fair value, and to carry out value assessments to prove this. Firms must act to deliver good outcomes, and there is an existing duty to have regard to customers' best interests. It therefore has some similarities with fiduciary duty and Value for Money duties on trustees. But there are wider considerations in the Consumer Duty: there are new obligations on consumer understanding and consumer support; firms must avoid causing foreseeable harm; and they must enable and support customers to pursue their financial objectives. The implication of this, from the perspective of how FCA-regulated pension firms invest (and enable their customers to invest), could include:
 - Judgments about whether investing in illiquids or other higher risk assets entails foreseeable harm, or whether it avoids the foreseeable harm of low returns.
 - A greater focus on enabling customers to understand how they are invested, to achieve their objectives. Engaging customers in investment decisions has long been a challenge for the pensions sector, despite recent successes such as the Pension Attention campaign.
- While the **charge cap on automatic enrolment DC default funds** presents an obvious upper limit on how much schemes can invest in more expensive assets, the reasons for introducing the cap are more important for this debate. This illustrates how policy has been partly responsible for driving the focus on cost, because it is easier to regulate charges than to regulate investment performance or service standards – much like choosing a pension based on these factors. While the OFT's Market Study into DC Workplace Pensions in 2013 found that "*investment quality is difficult to assess and ... this has focused competition on minimising the AMC*", its own recommendations focused on comparability of charges, and ensuring independent scrutiny of value, rather than comparability of investment performance²². It did not recommend a charge cap, but political debate on pension quality following the introduction of automatic enrolment centred on the level and transparency of charges. While cost is clearly important, only now is the political narrative shifting towards value in the round.
- In DB pensions, particularly closed ones, the focus of regulators and of schemes is on **paying out the guaranteed benefits**. These are fixed liabilities, and both TPR and PRA consistently prioritise ensuring that savers will be paid what they have been promised. In very different ways, they do this by steering the investments that schemes and firms hold and requiring them to demonstrate that these assets will be sufficient to pay their members or policyholders the income for the rest of their lives. How these are

²²https://webarchive.nationalarchives.gov.uk/ukgwa/20131101172428/http://oft.gov.uk/shared_oft/market-studies/oft1505

regulated are very much live issues. The Government is consulting on the Solvency UK regime for insurers, with changes to aspects of the EU's Solvency II Directive. TPR has been expected to introduce a DB Funding Code, while the Bank of England has been increasingly interested in DB pensions and financial stability.

Considerations in private and illiquid asset investment

17. Much debate has focused on illiquid assets – those which cannot readily be encashed or transferred, and therefore by definition are longer-term. These assets, such as private equity (PE), venture capital (VC), private credit, infrastructure and property, can bring several benefits to investment portfolios. Certain types of illiquid assets, such as the new infrastructure required, will be essential in enabling both the Government and the pensions industry to deliver on their net zero commitments. Investment in less liquid assets could lead to better returns and then improve consumer outcomes, provided appropriate decision makers have the right expertise and apply appropriate due diligence. Although there is some evidence of illiquids outperforming their more liquid counterparts²³, there is no consensus on the existence or size of the difference and some comparisons include a survivorship bias²⁴ and imperfect comparisons of the rates of return²⁵. Investing in illiquids also means having access to a wider opportunity set, being able to better diversify assets, which can help manage portfolio risk, and can provide a more stable income and lower volatility than equities²⁶. Indeed, some of these properties of illiquids may be even more important than the size of the illiquidity premium. With the edge of private equity returns over public equity decreasing over time, it is thought that the return-smoothing properties are what make private equity attractive²⁷.
18. There are different challenges and considerations that pension funds and their asset managers need to work through.
- **Operational challenges** can make investments in unlisted equities more difficult and costly. They are not insurmountable, but explain the proportion and the pace with which pension schemes are increasing their investments in private assets. Illiquids are predominantly actively managed, which means there may be significant set up costs including the costs of research or development of supporting operational and governance structures²⁸.
 - **Managing liquidity** when investing in private equity is still a challenge for some schemes and depends to some extent on the certainty of the cashflow. For smaller schemes or those looking at consolidating, there is a risk of needing to disinvest from illiquids, which can discount the value of the investment, and lead to worse outcomes. Poorly managed liquidity can mean that savers face long waits for access to their pensions or extend transfer times well beyond the two weeks window of good practice²⁹. It may be difficult to match liquidity of funds under the LIFTS initiative which are largely invested in start-ups, under open ended structures including LTAF. This may require temporary exceptions to FCA rules.

²³ <https://www.pensionspolicyinstitute.org.uk/media/3112/20190325-dc-scheme-investment-in-illiquids-high-res.pdf>

²⁴ <https://www.british-business-bank.co.uk/wp-content/uploads/2019/09/Oliver-Wyman-British-Business-Bank-The-Future-of-Defined-Contribution-Pensions.pdf>


²⁵ <https://henrytapper.com/2022/01/12/a-roadmap-for-increasing-productive-finance-investment/>

²⁶ <https://www.actuaries.org.uk/system/files/field/document/Illiquidity%20white%20paper%20final%20v2.pdf>

²⁷ <https://www.actuaries.org.uk/system/files/field/document/Illiquidity%20white%20paper%20final%20v2.pdf>

²⁸ <https://www.actuaries.org.uk/system/files/field/document/Illiquidity%20white%20paper%20final%20v2.pdf>

²⁹ <https://www.abi.org.uk/globalassets/files/publications/public/lts/2018/trig--industry-wide-framework-for-improving-transfers-and-re-registrations--final.pdf>

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19. Ensuring member fairness is another challenge that providers and asset managers need to work through³⁰. For instance, in the case of private equity, the time at which capital is allocated has an impact on the realised returns, and returns are characterized by a J-curve, with low returns at the start and gradual increase in the later part of the life's fund, as is common in VC and PE.
 20. Gathering data for assessing the ESG credentials of private assets can be challenging. However, there may also be better opportunities to influence companies to adopt stronger ESG policies or set more ambitious goals. For instance, with private credit, investors can include ESG objectives as part of the private bond covenant.
 21. From a supply point of view, there aren't many private market funds on the market. There is particularly low availability of VC funds and very few platforms offer them. Alongside this, there is a limited choice of private equity managers (PPI)³¹. Limited supply is a challenge when it comes to infrastructure investments too. While 62% of pension scheme leaders expect to increase their investment in British Infrastructure over the next year, to achieve their net-zero ambitions and deliver stable, inflation-linked returns, 18% cited a lack of suitable investment opportunities³². One aspect that constrains the market of funds that invest in illiquids, including LTAFs, is the fact that they are only accessible to UK clients, since the UK is no longer part of the European market.
 22. There are existing schemes for individual investors to incentivise them to invest in start-ups³³. These include the Enterprise Investment Scheme (EIS), the Seed Enterprise Investment Scheme (SEIS) and Social Investment Tax Relief (SITR) (the SITR is no longer available for new investments after April 2023). Individuals can also invest in Venture Capital Trusts. These arrangements attract different tax reliefs to encourage capital into those unlisted equities. Consideration could be given to establishing similar schemes for pension arrangements.

Pension investments: where, how and why

23. Those managing pension fund investments on behalf of savers will have one key objective. This is to balance their portfolios with an appropriate amount of risk which will yield rewards for the saver: for DC, so that their retirement money has the best chance of growing over their working life; and for DB, to ensure that benefits are paid.
24. To do this, pension funds tend to invest in a balanced manner. DC pensions are invested in UK and international equities alongside other asset classes, including corporate bonds. Corporate bonds (or debt) are an attractive asset for pension funds. This is because they provide the holder with a steady annual yield, which is often higher than a dividend a company share would pay, and there is less of a threat of sequencing risk during a withdrawal phase³⁴. This is particularly important in retirement if someone has the vast majority of their retirement funds still invested in DC while withdrawing an income (which an increasing number of retirees are doing).
25. Illiquid investments also aim to achieve a balance – for example infrastructure and social housing can be less risky but may also offer lower levels of return than other opportunities. On the other hand, growth funding for businesses can offer higher returns but will come at a much higher level of risk, which is why portfolios with exposure to illiquids will often have a balance of each.
26. Maturity and future duration of the scheme also matters to investment strategy. The PLSA fairly characterises the typical maturity of DC and open DB as 30-100 years, compared to 10-15 years for closed DB (which will be similar

³⁰ <https://www.gov.uk/government/consultations/broadening-the-investment-opportunities-of-defined-contribution-pension-schemes/outcome/statutory-guidance-disclose-and-explain-asset-allocation-reporting-and-performance-based-fees-and-the-charge-cap>

³¹ <https://www.pensionspolicyinstitute.org.uk/media/4292/20230309-role-of-alt-assets-in-dc-investments-final.pdf>

³² <https://www.pensionsage.com/pa/Nearly-two-thirds-of-pension-professionals-set-to-increase-infrastructure-investment.php>

³³ <https://www.gov.uk/guidance/venture-capital-schemes-tax-relief-for-investors>

³⁴ “Sequencing risk” is the danger that the timing of withdrawals from a retirement account will harm the investor's overall rate of return.

for bulk annuities)³⁵. Any open scheme will be enrolling young people and must be assumed to last their lifetimes. Many closed DB schemes today are already mature and will be fully in payment by the late 2030s.

27. It is also important to recognise differences in investment approach based on the type and maturity of DC schemes. Historically, pensions tended to be “lifestyled”, where money is invested in higher risk assets whilst savers are young, and in lower risk assets as they approach their retirement. Generally speaking, this would be done automatically in workplace schemes, and by a financial adviser or the saver themselves in non-workplace schemes. However, since the Pension Freedoms were introduced in 2015, practice varies across the market as more people remain invested for longer but with the ability to encash from age 55.



The workplace DC market – where and how schemes invest

28. The vast majority of savers are in default funds, whose portfolio is determined by the provider. People can opt to change funds (for instance, move their money into more sustainable options), but because AE relies on inertia where many people are unaware of, or uninterested in, their pension saving, few do. Some providers offer multiple default funds for employers to choose from. It is plausible that ‘patriotic funds’ with a ‘tilt’ to UK investments could be developed and offered to employers.
29. DC schemes are largely invested in equities (55%) and bonds (17%)³⁶, and this split will vary between providers, and often between customers depending on age. More recently, there has been a trend away from simple equity and bond portfolios to a greater level of diversification into growth assets, such as private markets, global infrastructure, real estate and commodities. Master trusts allocate an average of 3% of their assets into infrastructure investment³⁷, but the allocation of default funds varies amongst providers from 2.8% to 14%³⁸ – this is natural and to be expected in a competitive market. Property makes up under 3% of asset allocation in default funds of those more than 5 years away from their State Pension Age³⁹, whilst commodities account for 2-4% in DC schemes⁴⁰. Providers are increasingly investing in private markets, with one leading the way with an allocation of 15%⁴¹. For a saver 30 years before State Pension Age, at least 5 default arrangements of leading automatic enrolment providers invest in private equity with allocations between 1.1% to 4.8% and at least three in private credit with allocations between 4.5% to 10%⁴². At least five providers are planning to increase their asset allocation in illiquids, with four specifically in private equity and/or private credit⁴³.

³⁵ <https://www.plsa.co.uk/Portals/0/Documents/Policy-Documents/2023/Pensions-and-Growth-Jun-2023.pdf>

³⁶ <https://newfinancial.org/report-unlocking-the-capital-in-capital-markets/>

³⁷ <https://www.pensionspolicyinstitute.org.uk/media/4292/20230309-role-of-alt-assets-in-dc-investments-final.pdf>

³⁸ Corporate Adviser data on Master Trust and GPP Defaults, 2023


³⁹ Corporate Adviser data on Master Trust and GPP Defaults, 2023

⁴⁰ <https://www.pensionspolicyinstitute.org.uk/media/4292/20230309-role-of-alt-assets-in-dc-investments-final.pdf>

⁴¹ <https://www.cushon.co.uk/blog/cushons-new-investment-strategy>

⁴² Corporate Adviser data on Master Trust and GPP Defaults, 2023

⁴³ Corporate Adviser data on Master Trust and GPP Defaults, 2023



30. Public data on existing holdings in private assets is sparse, because it is not collected consistently. It is often categorised as ‘alternatives’ or ‘other’, and unlisted securities may be included as a small proportion of ‘equities’ or ‘bonds’ along with listed ones. Private assets include real estate, infrastructure, operating assets, natural capital and corporate assets. New DWP regulations covering disclosure of investments allocated to different asset classes may help with the data challenge and develop a common understanding of exactly how pension schemes invest.

The workplace DC market – why they invest the way they do

31. DC pension providers’ objective is to try to maximise the chance of people’s pension investments performing well over the course of their working life to give them as large a pension pot as possible. This means that asset allocations in default funds will be suitably diversified so that risks are managed. A blend of investment in corporate and government debt, property, infrastructure and equities (both quoted and unquoted), will often be sought. This diversification will extend to the location of these assets, and so default funds will be not only invested in UK assets, but also overseas.
32. A focus on cost in the wider ecosystem is one of the key barriers stopping pension providers from investing in a wider class of assets. Master trusts have been vocal in the past about the focus on costs limiting their ability to develop their investment proposition⁴⁴. Our members tell us that in a tender for an employer’s pension scheme, schemes can be won or lost by a difference of a single basis point. They have highlighted that Employee Benefit Consultants, in their crucial role supporting employers and facilitating competition in workplace pensions, can sometimes overly focus on cost when selecting and recommending auto-enrolment providers to their clients. A majority of master trusts surveyed also said that clients and consultants do not put sufficient emphasis on the quality of investment propositions when selecting a provider⁴⁵.
33. The role of investment consultants is also key here in giving appropriate advice including on investing in productive assets and ensuring investment decisions are value for money in the long term. They have an incentive to focus on cost to demonstrate value in the short term. The fact that they are unregulated is also very likely to play a role in creating this cost-first environment. Combined with fierce competition for schemes between providers, this makes for an unhealthy cocktail of ever lower cost schemes at the expense of a more holistic focus on investment returns and service levels as equally important measures of value.
34. The effectiveness of measures already taken, such as exempting performance fees for investments in illiquid assets from the charge cap for automatic enrolment schemes, will be blunted as long as this low-cost culture persists.
35. The stated aim and expectation of the new Value for Money (VfM) framework, which was consulted on at the beginning of 2023, is for “employers to use VfM assessment results when deciding which scheme to automatically enrol their members into, or when considering whether the pension scheme their employees are in continues to provide value for money to their employees”. It is appropriate that employers and intermediaries who support them to meet their duties consider value for money in the round. We note the commitment made by consultants as part of the Productive Finance Working Group to deliver “advice to UK pension schemes based on an assessment of improved net member outcomes rather than solely on an assessment of costs and charges” and have heard of consultants who look at cost last.
36. Liquidity management is also a concern. Despite FCA changes to the permitted links regime, current practices on daily dealing and pricing also continue to present limitations to private equity investment.

⁴⁴ <https://dcif.co.uk/wp-content/uploads/2022/02/growing-pains-final-web.pdf>

⁴⁵ <https://dcif.co.uk/wp-content/uploads/2022/02/growing-pains-final-web.pdf>

DB pension schemes - where and how they invest

37. The PPF’s annual “Purple Book” details the pattern of DB schemes’ investment strategies. The latest data available (2022) shows that there has been little change in the proportion of assets in bonds and equities in the year to March 2022. The PPF have noted the aggregate funding position of DB pension schemes “*now exceeds the previous peak seen around 15 years ago, prior to the 2008-09 financial crisis*”⁴⁶.
38. The average weighted asset allocation for DB schemes in 2022 was broadly 27.1% equities, 58.5% bonds (including corporate) and 14.4% “other”, with other being mostly annuities, property and swaps⁴⁷. However, a majority holding in government or corporate bonds is not prevalent in all DB schemes. The PPF notes that for 15% of DB schemes, equities account for more than 50% of their total assets⁴⁸. Trends change with scheme size, with the proportion of assets held in bonds increasing with the amount of overall assets the scheme has. The opposite relationship applies to equities: the fewer assets a scheme has, the greater the proportion of equity investment. Of course, there will also be variations between individual schemes.

DB pension schemes - why they invest the way they do

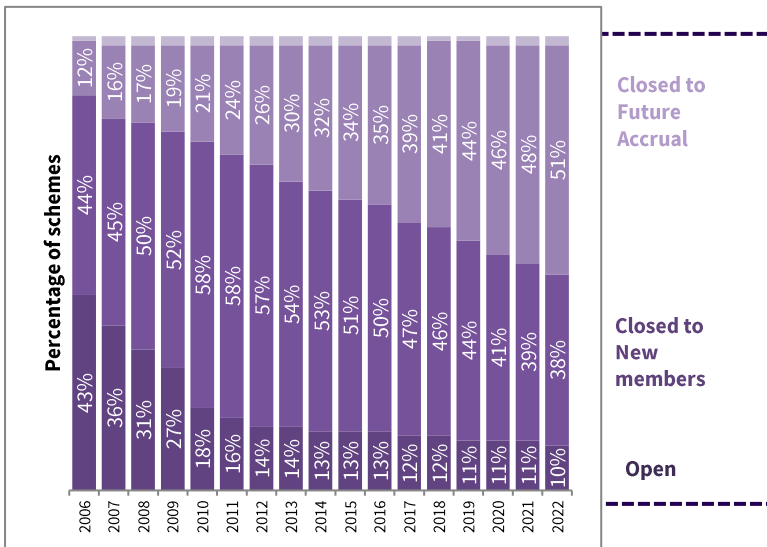


Figure 3: Proportion of DB schemes which are open, closed to new members and closed to future accrual (Source: PPF Purple Book, 2022)

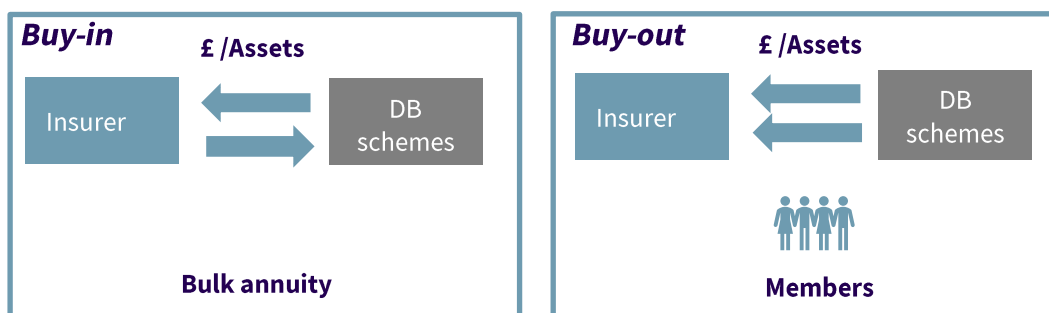
39. The vast majority of DB pension liabilities have a fixed duration (which is the case for the majority of private sector DB schemes, per Figure 3). This explains the common investment strategy to hold low-risk assets delivering steady cashflows to meet regular pension payments – like bonds. The more mature a scheme, the fewer equities it will typically hold as it progresses on its de-risking journey. The ability to offload this risk for an employer also becomes more attractive the more mature a scheme is.

⁴⁶ https://www.ppf.co.uk/-/media/PPF-Website/Files/PPF_-_Wpsc_DB_pension_schemes_inquiry_April_2023.pdf
⁴⁷ https://www.ppf.co.uk/-/media/PPF-Website/Public/Years/2022-11/PPF_PurpleBook_2022.pdf
⁴⁸ https://www.ppf.co.uk/-/media/PPF-Website/Files/PPF_-_Wpsc_DB_pension_schemes_inquiry_April_2023.pdf

40. This ambition is now shared by the majority of private sector DB schemes' employers and trustees. 75% of DB schemes are now targeting insurer buyout, and around 40% of those expect to fully insure in the next 5 years⁴⁹.

The insurance sector plays a major role in consolidating and securing DB pension schemes. Employers can transfer the responsibility for their pension scheme by moving its assets and liabilities to an insurer for an exit payment, a “buy-out” transaction. Insurers have already consolidated £300 billion of DB assets from many hundreds of pension schemes, and look after the retirements of more than 1.6 million DB members.

How the insurer buyout market works



41. While capital rules (both Solvency II and Solvency UK) make investments in equities fairly unattractive, buy-out insurers invest pension money directly into the fabric of UK society, from urban regeneration to social housing, renewable energy, electric vehicle charging infrastructure, and later living communities. Buy-out insurers are key to funding major projects in the UK. For example, the Thames Tideway Tunnel which helps prevent future sewage spills, the Hornsea 1&2 offshore windfarms (the biggest in the world), and Wirral Waters One, the UK's largest urban regeneration project.

How does the UK compare to other countries?

42. International examples are often provided in comparison to the UK to demonstrate the benefits of investing in illiquids. But data is sparse and not readily comparable, and international data does not support a simplistic narrative that UK returns are poor.
43. A presentation by the Association of Superannuation Funds of Australia in February 2023 showed UK funded and private pension plans outperforming all other nations listed in the period 2010 to 2019. Even though UK performance will have changed since 2019, this would vary considerably between types of schemes, and between schemes.
44. In Pensions at a Glance 2021, the OECD listed average annual rates of return of retirement savings plans for the 5- and 10-year periods to 2020, covering public and private schemes (this excludes the UK)⁵⁰. The highest real return was in Costa Rica, and the highest nominal return was in Turkey, but these nations' pension systems are rarely cited as examples to follow. International comparisons are instructive, but of limited use without understanding the reasons for the results, and local economic factors. These comparisons also tend to mix both private and

⁴⁹ <https://readymag.com/u43676151/planning-your-journey-to-buy-out/>

⁵⁰ https://www.oecd-ilibrary.org/sites/ca401ebd-en/1/3/9/5/index.html?itemId=/content/publication/ca401ebd-en&_csp_ =9d37797bd84847326841f27f588be463&itemI GO=oe cd&itemContent Type=book#indicator-d1e75979

public schemes, and both DB and DC structures of different maturity. For example, the Canadian CPPIB is a public sector DB scheme and the large US schemes are also public.

45. The Australian superannuation experience is most valuable for comparisons with workplace DC in the UK, although there are still major differences.

Case Study: Australia

- In Australia, asset allocation between growth and defensive is about 70% to 30%, with growth assets including both public equity and unlisted equities as well as alternatives (see table below)⁵¹. The Australian default arrangements ('my super') invest about 24% of their assets into alternatives (listed property 2%, unlisted property 6%, infrastructure 10%, unlisted equities 6%).
- Australian default arrangements have slightly higher returns than those in the UK. In the UK, according to calculations based on Corporate Advisor data⁵², workplace pension default funds had a median of 4.92% p.a in the last five years for a saver 30 years away from State Pension age (returns before charges). For an equivalent saver in an Australian retail lifecycle fund (which de-risks according to the decade one is born into), the median returns in last 5 years was 5.8% pa (net of fees and tax and before administrative charges and adviser commission)⁵³.
- There are a few reasons why Australian default funds invest more in growth assets. Part of it is historical. Firstly, unlike the UK, Australia does not have a well-developed bond market. Secondly, the 13 Industry Super Funds with five million members (about a quarter of adult population), are run by employer associations and/or trades unions which allows them to rely on a positive cashflow, making it much easier to invest in illiquid assets and long-time horizon assets. The fact that pension pots follow the member when they change jobs also helps in that respect.

Figure 4: MySuper funds allocation (Source: APRA March quarter 2023)

Assets	Amount (\$bn)	%
Cash	28	3
Australian fixed interest	111	12
International fixed interest	65	7
Australian listed shares	187	20
Listed property	18	2
Unlisted property	58	6
International shares	265	28
Infrastructure	96	10
Hedge funds	-	-
Unlisted equity	55	6
Other	75	8
Total	910	100

⁵¹ https://www.superannuation.asn.au/ArticleDocuments/269/SuperStats_May23.pdf.aspx?Embed=Y

⁵² Corporate Adviser data on Master Trust and GPP Defaults, 2023

⁵³ <https://www.superguide.com.au/comparing-super-funds/lifecycle-investment-options>

- Consolidation is another reason for their ability to pool funds. The 16 largest of these funds hold⁵⁴ more than \$50 billion in funds under management (FUM)⁵⁵ and collectively, cover 70% of Australia's superannuation assets. Schemes pooled their funds together and created *Industry Funds Management* to invest in big infrastructure projects at a time of privatisation; by doing so, they reduced their fees. Vehicles that pool funds, such as the IFM in Australia and the new LTAFs in the UK, can help schemes invest more in alternative investments. However, consolidation brings about other issues. Larger schemes typically focus on bigger investments, especially in infrastructure. This means that smaller projects do not receive as much access to capital, especially smaller private equity or venture capital deals.
- The increased investment in unlisted assets has not been uncontroversial. For example, some recent valuations saw supers with the heaviest exposure to unlisted equities outperforming others, despite equivalent public investment asset classes suffering significant declines⁵⁶. For instance, the Property Council of Australia showed that unlisted property funds recorded gains of nearly 19% in the first nine months of 2022, whilst there was a 20% drop in the valuation of listed property funds. Last year, a handful of supers were questioned by the regulator after an over-valuation and delay in the auditing of the valuation of a high-flying unlisted tech stock Canva, despite the collapse of listed tech stocks⁵⁷.
- Their regulator APRA has signalled that it will look much more closely at how supers value their sizeable investments in unlisted assets, such as infrastructure, private equity and property. A 2021 review conducted by APRA concluded that too few supers had robust frameworks for revaluing unlisted assets and some funds were relying too heavily on external parties, such as fund managers and asset consultants.

⁵⁴ <https://www.apra.gov.au/news-and-publications/apra-chair-wayne-byres-speech-to-finsia-conversation-wayne-byres-event>

⁵⁵ <https://www.apra.gov.au/news-and-publications/apra-chair-wayne-byres-speech-to-finsia-conversation-wayne-byres-event>

⁵⁶ <https://www.afr.com/companies/financial-services/watch-the-secret-super-valuation-gap-20230123-p5ceoi>

<https://www.afr.com/companies/financial-services/watch-the-secret-super-valuation-gap-20230123-p5ceoi>

⁵⁷ <https://www.afr.com/chanticleer/canva-s-secret-value-tests-apra-20220720-p5b32z>

<https://www.afr.com/chanticleer/canva-s-secret-value-tests-apra-20220720-p5b32z>

Section 2 – How policy has shaped pension fund scheme investment

Existing Policy	
Investing in illiquids	New regulations ⁵⁸ confirm policy developed in the last few years to encourage investment in illiquids : <ul style="list-style-type: none"> Occupational pension schemes must disclose their policy on illiquids – what proportion of their investments are in illiquids and other assets, and why. Exempt performance fees from charge cap calculations.
Long-Term Asset Funds	Following the work of the Productive Finance Working Group in 2020/21, Long-Term Asset Funds are now being set up for workplace pensions, and the FCA recently confirmed rules to extend retail and pension access to LTAFs.
FCA permitted links rules	Following HMT’s Patient Capital Review in 2016/17 and work by the Law Commission in 2017 on Pension Funds and Social Investment, the FCA made some changes to its permitted links rules to allow some investment into long-term assets within unit-linked funds often used by DC pensions ⁵⁹ .
ESG investment	The Pension Schemes Act 2021 signalled an interventionist approach to investment by DWP, in relation to climate change . But it did not go as far as allowing DWP to mandate investments, only requirements to how schemes assess and measure risks ⁶⁰ .
Policy being developed	
Value for Money in DC	Overlapping value for money requirements from DWP, FCA and TPR are converging through the consultation on metrics submitted in March. This builds on DWP regulations from 2021 which require schemes with <£100 million to do value assessments and justify why they are not consolidating ⁶¹ .
DB Funding Code	The final version of the DB Funding Code will come into force in 2024. It will have DB scheme endgame implications and could impact open schemes’ investment strategies.
LGPS	Consultation in progress to get LGPS to move further and faster in consolidating their assets in single pools. This also consults on requiring LGPS funds to consider investment opportunities in illiquid assets such as venture and growth.
Regulation & policy around personal pensions	FCA are introducing defaults and quasi-defaults into personal pensions, which could conceivably be appropriate for illiquid funds. From December 2023, non-workplace pensions sold without advice must offer a default option. Since February 2021, customers entering drawdown without advice have been offered investment pathways based on how they intend to access their funds in the next five years. DWP is due to make equivalent proposals for occupational schemes. In both areas, the FCA also requires warnings for customers invested in cash.
Long-term Investment for Technology & Science	Consultation in progress on a new Government co-investment scheme to increase investment in the UK’s most innovative science and technology companies.

⁵⁸ <https://www.legislation.gov.uk/ukxi/2023/399/contents/made>

⁵⁹ <https://www.fca.org.uk/publication/policy/ps20-04.pdf>

⁶⁰ <https://www.legislation.gov.uk/ukpga/2021/1/section/124/enacted>

⁶¹ <https://www.legislation.gov.uk/ukxi/2021/1070/contents/made>

Section 3 – Saver-first policy recommendations

There have been a multitude of proposals put forward on how to use pensions to encourage growth in the UK economy, and into particular sectors. Each has its pros and cons and practical implications. Here we present specific recommendations and broad principles that should apply to any intervention the Government considers.

Overall principles for reform

- **Any policy interventions must put savers first.** The litmus test for any new policies must be that they deliver better outcomes for savers, given that the money in pensions belongs to individuals and is intended to secure their standard of living in retirement. Pension schemes investing in savers' interests is entirely compatible with investing in the UK economy, but the former must take precedence.
- **Change must be part of a long-term strategy for pensions policy.** It should address both the quantity of investment as well as the quality of investment. Change must also be sequenced logically, with a shared and realistic understanding of the likely scale and pace of change. Current and recent changes (such as LTAFs and disclosure requirements) will lead to increased investment in illiquids, but wider changes (such as the VfM framework) will inevitably take longer to take root. Lessons can always be learnt from the cross-party, consensus-driven, evidence-based approach of the Turner Commission.
- **Decisions about how to invest are for pension schemes to make. It is inappropriate for Government to mandate that pension money is channeled into particular sectors of the economy.** This is because different administrations will inevitably have different political priorities for sectors needing support, but pension investment should be driven by a focus on the long term. It would also cut across providers' Consumer Duty and professional, commercial decisions as well as trustees' fiduciary duty – any restriction or requirement carries risks for consumers. Mandating would also create reputational and commercial risks for Government, in the event of underperformance of assets. Voluntary initiatives, led by the industry with government input, where firms can commit individually or collectively to certain groups of assets, are more appropriate.
- Any interventions to change the way pensions are invested must be well thought through to **avoid unintended consequences and acknowledge trade-offs**. This includes, for example, creating an asset bubble, or increasing concentration risk in certain firms or sectors. Policy also needs to recognise natural limits on the proportion of default funds that can be allocated to illiquids, including the need for liquidity, and trade-offs with other policy goals – such as easy access to pension freedoms and rights to transfer pensions.
- Government should **avoid rushing market-shifting changes** to the structure of pensions markets.
 - There is a place for Collective DC in the pensions market as one way to help savers achieve a predictable income, and they can theoretically invest in long-term assets at scale. However, a great deal more thought is needed before it can be introduced commercially, particularly as a decumulation option. There is no evidence that decumulation-only CDCs would provide better outcomes, and long-term investments are less appropriate for them. CDCs should be just one option and would need to be regulated appropriately to avoid regulatory arbitrage, and risks of poor consumer outcomes.
 - Similarly, so-called "Superfunds" are seen as one way of consolidating DB schemes, but are untested with no transactions to date. Insurers have a long history of consolidating DB assets via buy outs and

have the scale to invest in productive assets already. The rationale for introducing DB “Superfunds” was to provide an option to transfer risk to employers of DB schemes who could not afford to buyout with an insurer. To avoid regulatory arbitrage, a ‘gateway test’ was proposed to ensure only schemes unlikely to buy out with an insurer in the foreseeable future can transfer to a Superfund. This is still appropriate. Superfunds need to be appropriately regulated to protect members’ pension money, and transactions should only occur once a permanent regime is in place through legislation. A relaxation of the rules for Superfunds and those transacting with them, to create a cheaper and riskier alternative, must be avoided in the interests of the scheme members.

- Any expansion of the PPF’s role would need to address complex questions of cross-subsidy from other DB schemes, the Government’s role in underwriting the scheme, the question of benefit reduction/ harmonisation and issues of moral hazard given this might dissuade employers from seeking full protection for their scheme members via an insurer buy-out.
- **Intervention is also needed on the supply side.** Long term investors, including pension schemes and insurers more generally, need **governments to set the economic scene** appropriately so that they have confidence to invest on behalf of their beneficiaries in that jurisdiction. The UK is competing for capital on a global stage, and recent foreign Government interventions such as the US Inflation Reduction Act, and the EU’s Green Plan are aimed at increasing such investment. The UK must have an attractive offering too. This will then naturally attract greater capital from pension funds. Some of this is already in train, such as the Edinburgh reforms for financial services, but it is relevant across the economy.

ABI recommendations for the shorter term

1. Shift the culture from a focus on (low) price to holistic Value for Money in auto-enrolment DC

- As already recommended by the CMA, FCA and the Work & Pensions Committee of the House of Commons, employee benefit consultants should be regulated for the advice they give to employers on pensions. Not only would this avoid conflicts of interest, it would also set standards for their authorisation, qualifications and advice, including advising on investing in productive assets. This would also have the benefit of demonstrating Value for Money of their investment advice under the Consumer Duty.
- TPR guidance on DC investment governance should be reviewed as currently there is a distinct emphasis on cost. The guidance should empower trustees to use active investments where this fits their objectives, assess value holistically and only look at costs as one element of their value for money assessment⁶². The DWP’s default fund guidance (unchanged since 2011) should also integrate the VfM framework once completed, to ensure overemphasis on costs is rebalanced towards a more value-oriented approach⁶³.

2. Use DWP and FCA’s Value for Money framework to drive value and where DC schemes are not providing value, drive consolidation

- The Value for Money framework should be a key tool for improving performance of the sector and not just assess value, but be a driver for better value in the market. If DC schemes are unable to

⁶² One of the investment beliefs suggested in the guidance is “Finding investment managers who can consistently spot and exploit market opportunities is generally difficult; passive management is therefore an appropriate option.”

⁶³ https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/220170/def-opt-guid.pdf

demonstrate Value for Money to regulators, there should be swift and decisive action to force them to demonstrate how they will improve, and ultimately to wind them up and consolidate them if they don't.

- Subject to how the framework is delivered, in principle we support applying it to schemes with over £100 million and giving TPR enough powers and resources to use the framework as a tool to force consolidation of underperforming schemes into other workplace pensions which will compete for that business.
- The final framework and how it is used needs to truly embrace the focus on value, of which cost is only one element and focus on the net investment returns, as well as appropriately capturing service standards. Whilst the stated objective of the VfM framework is to move away from focusing just on cost, the international experience (New Zealand and Australia) referenced in the consultation was solely related to how changes to policy led to a reduction in fees, and not an increase in Value for Money.
- The VfM framework is a good example of DWP, TPR and FCA working in tandem, but it still illustrates differences in regulation. The FCA already has powers to act against providers which fail to meet its rules and principles, but there is little need for consolidation because it has already occurred, and there are major barriers to transferring without consent. Contract-based providers must have value assessments under the Consumer Duty, in addition to reporting to their independent governance committees, while occupational schemes have existing duties such as Chair's Statements. These layers and overlaps of regulation should be reviewed as the VfM framework is finalised.
- The framework should also avoid unintended consequences, including:
 - Discouraging diversity and competition in delivering VfM, by moving to a system where all schemes offer identical products and are not encouraged to innovate.
 - Creating a system where changing providers in response to short term metrics is encouraged, which would be counter to the very objective of long-term investment and value.
 - Prompting safer investments by schemes with an incentive to be 'in the pack' rather than comparatively underperforming at risk of being closed down. Schemes need to be confident that they will not be penalised for adopting a long-term investment strategy.
 - Imposing costs greater than the benefit to savers from consolidating schemes, for example in closing mature schemes in run-off and taking into account loss of guarantees.

3. Learn from and build on the Long-term Investment For Technology and Science (LIFTS) initiative

- We support the LIFTS initiative which would see £250 million of co-investment from Government to support DC investment into the science and technology sectors and develop the link between the venture capital ecosystem pension investment. The Government should use the initiative to evaluate the best ways to partner with the industry and create an ecosystem that unlocks investment in other areas beyond science and tech and can be scaled up.
- If the Government wishes to increase investment, it can provide incentives to do so; if it wishes to couple this with boosting UK pensions, it can make such incentives exclusive to UK pension schemes. The Government's proposal for co-investment initiatives such as LIFTS are a good example of this. The Government should explore incentives for pension funds to invest more in assets that are important to its policy objectives, especially where these are more expensive and riskier and therefore less attractive to pension schemes. Lessons could be learned from the EIS and SEIS reliefs. In line with Consumer Duty and fiduciary duty, providers and schemes must focus on consumer


outcomes, even if they may be sympathetic to Government aims. Incentives could shift the balance of risk and reward so that providers are more attracted to certain assets, in the interests of savers.

4. Ensure regulation makes it as easy as possible to invest in illiquids, including through LTAFs

- We are pleased to see the initial take up of LTAFs, particularly by insurers and through unit-linked and with-profit funds. We were closely involved in the Productive Finance Working Group and our members are among the first to offer LTAFs, so will continue to encourage providers and asset managers to consider using the structure to invest in productive assets.
- We welcome the FCA's changes to the permitted links rules which give other vehicles investing in illiquid assets equivalent status to LTAFs where an appropriate degree of consumer protection can be met.
- The Government and regulators should explore additional related interventions, including the following:
 - To facilitate investment in high growth private equity under LIFTS scheme, the FCA should consider introducing new exemptions to permitted links for closed ended alternative investment funds that meet LIFTS initiative criteria, like those afforded to LTAFs.
 - The FCA should work with the industry to ensure the permitted links rules do not constrain firms from making these investments.
 - In doing so, they should ensure that the rules are straightforward and effective at facilitating productive as well as nature-based investments under the right protections.
 - Under the new FCA changes, which would allow non-default DC funds to invest in LTAFs as well, it is unclear what the triggers for disclosures of unit-linked funds towards consumers would be. The FCA should clarify these obligations and ensure they are meaningful. For instance, disclosures of changes to asset allocation are not useful unless they result in material changes to the risk profile.
 - To enable firms to create the operational structures for increased investment in illiquids, the FCA should work with the industry to ensure there are clear, shared expectations about the operating models, communications, governance, data and skills required.

ABI recommendations for the longer term

1. **DB schemes with little or no prospect of achieving buy-out could be given access to The Pension Protection Fund's scale and investment capabilities**, provided that employers retain their obligations and full benefits are still paid, and employers continue to pay the PPF levy and are required to work towards a fully funded position. A more expansive role for the PPF as has been mooted elsewhere would be a major market intervention in a market where there is no market failure, through introducing a competing public provider. It would also risk undermining member security and introduce moral hazard of employers neglecting their schemes. Any new remit for the PPF would open up complex questions about who pays for the expanded role, whether there would be cross-subsidies with the PPF's existing compensation framework, and whether Government would take on the PPF's assets and liabilities, to name but a few.

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2. Further consolidation is also appropriate for the 86 **Local Government Pension Funds (LGPS)** which together administer £369 billion in assets for the retirements of local authority workers. Under pressure from previous administrations, England and Wales formed eight pools each with assets of at least £25 billion. However, local authorities also continued to invest in their own funds, and the overheads for the LGPS have increased to 0.55% - comparing unfavourably to the Canada Pension Plan Investment Board (“CPPIB”) which is of a similar size but with costs of only 0.27% - a difference of £1 billion a year. Furthermore, costs have risen by £1 billion since pooling began. The ABI supports the proposals in Budget 2023 to speed up the pace and scale of LGPS pooling – if a single pool was created, it would at one stroke rival the large funds overseas, with similar benefits for reduced costs and more diverse investments. For example, the CPPIB invests c.35% of its portfolio in infrastructure.
 3. Finally, the UK’s DC workplace pension system, although growing rapidly, is only in its infancy. Contributions stand at 8%, but are only applicable to a band of earnings which means that the real contribution rate for many will be slightly lower. Compare this to the Australian superannuation rate (paid by the employer) of 10.5% (11% from July 2023), rising to 12% in 2025, and it is clear we need a long-term plan to increase savings rates if we want to aspire to similar levels of DC maturity. We have previously laid out plans to **gradually raise employer and employee contributions over the next 10 years** to 2032. Government should engage with this and chart a path towards raising rates. For a start, Government should press ahead with its plan to increase AE contributions by removing the lower earnings limit and by starting automatic enrolment at age 18 instead of 22. Only by increasing the flow of new assets into DC pensions can we hope to provide more capital for UK plc, and better retirement incomes, in the future.



ABI

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The Association of British Insurers is the voice of the UK's world-leading insurance and long-term savings industry, representing over 200 member companies.

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