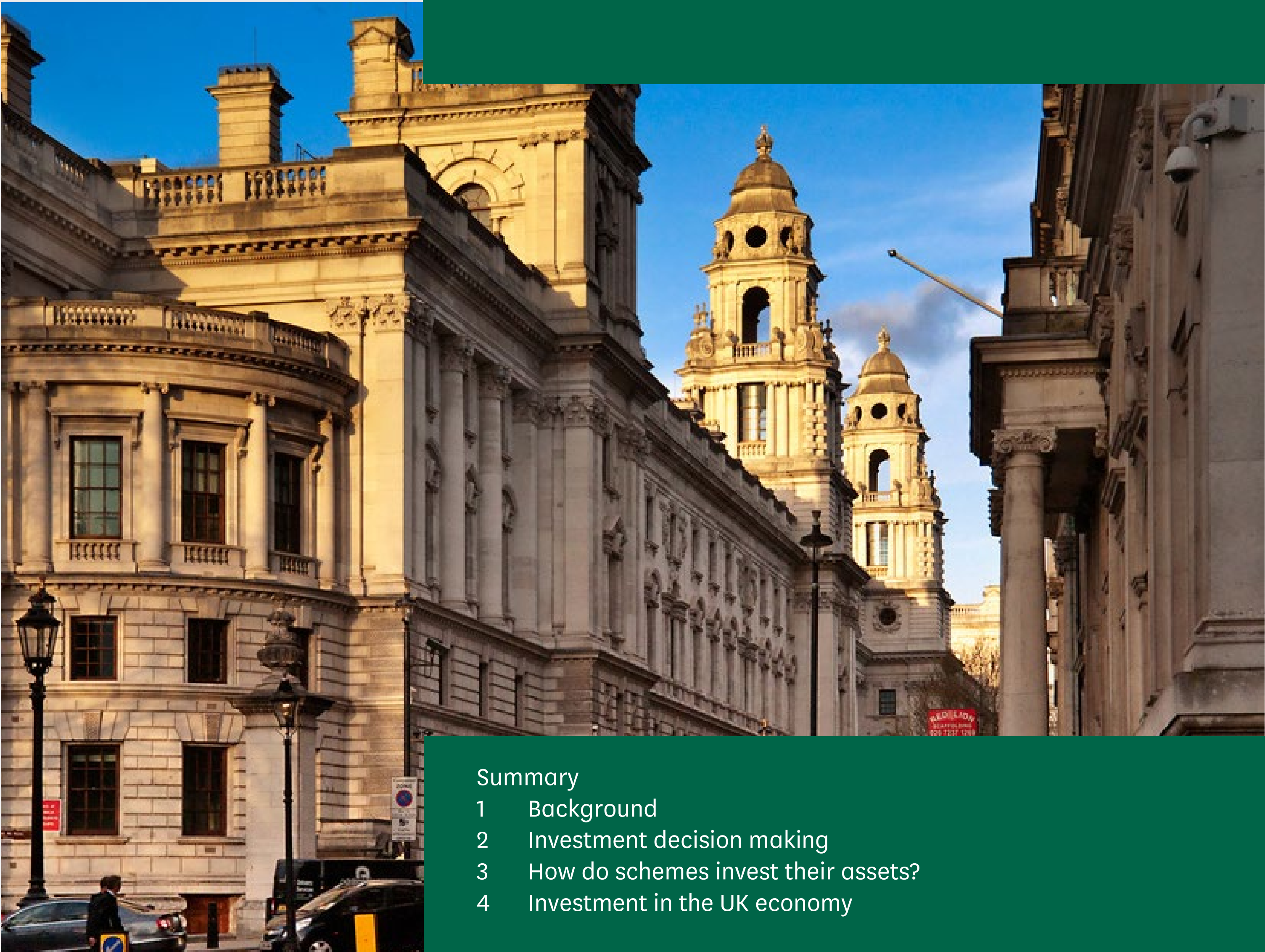
House of Commons Library

Research Briefing

18 November 2024

By Djuna Thurley,
James Mirza-Davies

Pension scheme investments



Summary
1 Background
2 Investment decision making
3 How do schemes invest their assets?
4 Investment in the UK economy

commonslibrary.parliament.uk

Number 10146

Contributing Authors

Rachael Harker

Image Credits

Birdcage Walk and HM Treasury by Kiril Strax. Licensed under CC BY 2.0 / image cropped.

Disclaimer

The Commons Library does not intend the information in our research publications and briefings to address the specific circumstances of any particular individual. We have published it to support the work of MPs. You should not rely upon it as legal or professional advice, or as a substitute for it. We do not accept any liability whatsoever for any errors, omissions or misstatements contained herein. You should consult a suitably qualified professional if you require specific advice or information. Read our briefing 'Legal help: where to go and how to pay' for further information about sources of legal advice and help. This information is provided subject to the conditions of the Open Parliament Licence.

Sources and subscriptions for MPs and staff

We try to use sources in our research that everyone can access, but sometimes only information that exists behind a paywall or via a subscription is available. We provide access to many online subscriptions to MPs and parliamentary staff, please contact hoclibraryonline@parliament.uk or visit commonslibrary.parliament.uk/resources for more information.

Feedback

Every effort is made to ensure that the information contained in these publicly available briefings is correct at the time of publication. Readers should be aware however that briefings are not necessarily updated to reflect subsequent changes.

If you have any comments on our briefings please email papers@parliament.uk. Please note that authors are not always able to engage in discussions with members of the public who express opinions about the content of our research, although we will carefully consider and correct any factual errors.

You can read our feedback and complaints policy and our editorial policy at commonslibrary.parliament.uk. If you have general questions about the work of the House of Commons email hcenquiries@parliament.uk.

Contents

Summary **4**

1 Background **6**

1.1 What types of pensions are there? 6

1.2 The pensions landscape 7

1.3 Value of assets 8

2 Investment decision making **10**

2.1 Who is responsible for investment decisions? 10

2.2 The legal framework 12

2.3 What factors drive decisions? 12

3 How do schemes invest their assets? **14**

3.1 Asset allocation by scheme type 15

3.2 To what extent are UK pension funds invested in the UK economy? 17

3.3 How does this compare internationally? 18

4 Investment in the UK economy **20**

4.1 The 2024 pensions investment review 20

4.2 Background 23

4.3 Fiduciary duties 24

4.4 Value for Money 28

4.5 Defined contribution scheme consolidation 32

Summary

The pensions investment review

The government launched a pensions investment review in August 2024, led by the Minister for Pensions Emma Reynolds. The review is seeking to boost investment, increase saver returns and tackle waste in the pensions system.

An interim report was published on 14 November 2024. Full recommendations will be published in 2025. Following the interim report, the government sought further views on proposals to increase scale and consolidation and looked at how pension fund investments could support UK economic growth. The interim report also set out proposals for the local government pension scheme on pooling assets and strengthening governance for consultation.

How do pension schemes invest?

Pension schemes invest in different types of assets: including bonds (fixed-income investments) issued by corporations and governments, equities (shares in companies), property, infrastructure, and other alternative investments.

Defined contribution (DC) schemes do not provide a guaranteed pension and instead provide people with a pot of money they can use in retirement. The value of the pension pot can increase or decrease depending on factors, including investment returns and contributions made.

It is not straightforward to work out how UK DC schemes invest between different types of asset, partly due to inconsistent and overlapping definitions. The Pensions Policy Institute estimated that pension schemes invest 6% of their assets in a narrow definition of UK productive assets – including only private equity and alternative investments. Using a broader definition that includes publicly listed equities, corporate bonds, private equity, and alternative investments – the share was 18%. The pattern of asset allocation varies significantly by type of scheme.

Encouraging investment in the UK economy

Successive governments have looked for ways to get UK pension schemes to do more to support the UK economy, while at the same time providing the

potential for improved outcomes for pension savers. The current government wants "to overcome the barriers to increasing pension fund investment in UK productive assets to support our capital markets, which in turn will drive growth in our economy and improve the retirement outcomes for future pensioners."

In a call for evidence, published in September 2024, the government asked for views questions on consolidation, value for money, and investment in the UK. Building scale through consolidation could improve investment decisions because larger schemes tend to have better governance and greater capacity to make complex investment decisions. Proposals for a value for money framework are intended to encourage a greater focus on investment returns and service standards, in addition to costs and charges.

The Pensions and Lifetime Savings Association says that, while these measures are important, they are not a 'silver bullet' for driving investment into UK productive finance. They would need to be part of a "much broader strategy," including the development of suitable investment opportunities, fiscal incentives and policy certainty.

The Association of British Insurers identifies a risk of policy on value, scale and consolidation unintentionally conflicting with the Government's policy of increasing investment in UK assets. For example, if recent underperformance of UK equities were to continue, it could reflect poorly in the value metrics of those invested in them, which would have significant consequences for those businesses. Nor would scale and consolidation necessarily increase weighting towards the UK, as bigger schemes can access a wider pool of assets globally.

For organisations representing pension trustees, a core principle is that they should continue to be free to make decisions in line with their fiduciary duties to act in the best interests of scheme beneficiaries.

Defined contribution pension schemes

This briefing concentrates on defined contribution (DC) schemes, where employer and employee contributions are paid into a fund which is invested and then then be used to provide an income stream at retirement, where the value of the fund will vary according to contributions made, investment returns, costs and charges and decisions when savings are drawn.

Alongside its work on DC schemes, the Government is also looking at consolidation and governance in the Local Government Pension Scheme (LGPS). The LGPS is a defined benefit (DB) scheme which provides a guaranteed income in retirement based on salary and length of service. For more on the background, see Commons Library research paper, Local Government Pension Scheme investments. Separate work is also ongoing to consider how DB schemes might invest more in the UK economy.

1 Background

1.1 What types of pensions are there?

There are two main types of pension scheme:

- Defined benefit (DB) pension schemes pay a promised pension which is based on factors such as salary and length of service. A sponsor, which is usually an employer, guarantees the promised benefits are paid. The pension provides an income for life and may also include a retirement lump sum.
- Defined contribution (DC) schemes do not provide a guaranteed pension and instead provide people with a pot of money they can use in retirement. The value of the pension pot can increase or decrease depending on factors, including investment returns and contributions made.

A third, much newer type is a Collective Defined Contribution (CDC) scheme, where both employer and employee contribute to a collective fund. CDCs provide a target income in retirement, with the option to adjust pensions if the scheme is under or over funded. More detail is available in the Library briefing Pensions: Collective Defined Contribution (CDC) schemes.[1]

Private sector pension schemes can be either:

- Contract-based - managed and governed by a pension provider (generally an insurance company). These can be work-based - such as Group Personal Pensions (GPPs), designed for a group of employees working for a single employer - or individual personal pensions.
- Trust-based – set up under trust and managed by a board of trustees, who have full responsibility for the management, administration and investment of the funds, in the interests of scheme beneficiaries.

Private sector DB and CDC schemes must be trust-based; DC schemes can be trust-based or contract-based.[2]

1 Commons Library research briefing CBP 8674, Pensions: Collective Defined Contribution (CDC) schemes

2 Pension Schemes Act 2021, s3; Until 6 April 2006, occupational pension schemes had to be set up under trust to be eligible for tax relief, The Fiduciary Duties of Investment Intermediaries – Summary report (PDF), 2014, Law Commission, footnote 6

Defined contribution schemes and auto-enrolment

Employers are legally required to auto-enrol qualifying workers (aged between 22 and state pension age and earning above £10,000) into a pension scheme. Unless the worker opts out, the employer must make minimum contributions (3% of a band of 'qualifying earnings').[3] The vast majority of those auto-enrolled, are placed in DC master trusts, which are set up for multiple, unconnected employers to use.[4]

Schemes used for auto-enrolment are required to have a default arrangement into which they place savers so that they do not have to make a choice.[5] This enables them to harness the power of inertia. The vast majority of savers in master trusts save in the default arrangement.[6]

1.2 The pensions landscape

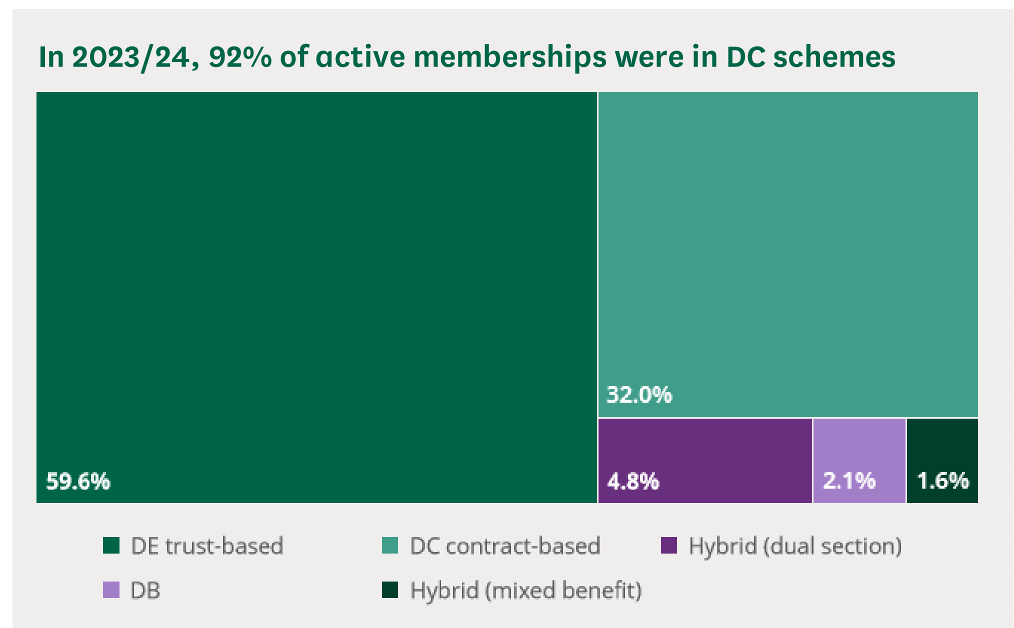
The workplace pensions landscape is changing, with a shift from DB to DC:

- The total number of members of private sector DB schemes fell from 12.8 million in 2012 to 9.6 million in 2023. Almost three in five (59%) private sector DB schemes are now closed to future build-up of benefits. The number of active members (those building-up benefits for current service) of DB schemes fell from 2 million in 2012 to 0.7 million in 2023.[7]
- Membership of DC schemes has grown since the introduction of auto-enrolment from 2012: total membership rose from 2.1 million in 2011 to 21 million in 2019; active membership rose from a low point of 0.9 million in 2011 to 10.6 million 2019.[8]

As shown in the chart below, according to the Pensions Policy Institute (PPI), around nine in ten active memberships are now within DC schemes: with around six in ten in trust-based DC and three in ten in contract-based DC. [9]

---

3 Pensions Act 2008, chapter 1; Commons Library research paper CBP 6417, Pensions: automatic enrolment – current issues
4 DWP, Evolving the regulatory approach to master trusts, November 2023
5 Pensions Act 2008, s17 (2)
6 DWP, Evolving the regulatory approach to master trusts (PDF) ,November 2023, paras 4 and 8
7 TPR, Occupational defined benefit (DB) landscape in the UK 2023, Figure 5
8 ONS, Occupational pension schemes in the UK, 13 January 2021, Table 3
9 PPI, The DC Future Book 2024, September 2024, p21



Source: Adapted from Chart 2.4 The DC Future Book 2024, Pensions Policy Institute

The DC workplace pensions market includes single-employer trusts, master trusts and contract-based workplace pensions such as Group Personal Pensions (GPPs). Although, as discussed in section 4.5, schemes have consolidated considerably in recent years, it is currently large and diverse, with a long tail of small schemes.[10]

1.3 Value of assets

According to the PPI, the data on how UK pension scheme assets are invested is "slippery, fragmented, inconsistent and incomplete." Combining different and incomplete data sets, it estimates that towards the end of 2023, the assets of the UK pensions sector were valued at just under £3 trillion. [11] Based on Office for National Statistics figures, private sector DB represents 55% of the total, with an estimated £1.12 trillion assets under management (AUM) in September 2023.[12] DC schemes had an estimated £1 trillion in assets (£0.31

[10] PPI, The DC Future Book 2024, September 2024

[11] Jackie Wells, Pension scheme assets – how they are invested and how and why they change over time, Pensions Policy Institute, September 2024. For the different data sources, see p8

[12] As above. The estimate is from ONS' Financial Survey of Pension Schemes (March 2024). It includes buy-in annuities purchased by schemes and is net of borrowing and liability driven investment positions. Based on returns to TPR, the Pension Protection Fund (PPF) has a higher estimate of the value of AUM in private sector DB schemes (£1,434 billion, March 2024). In its March 2024 report on Defined benefit pension schemes, the Work and Pensions Committee noted this discrepancy and recommended that DWP and TPR work with the ONS to understand the true position (para 19).

trillion in contract-based DC workplace schemes, £0.49 trillion in individual personal pensions and £0.24 trillion in trust-based DC workplace schemes):[13]

Distribution of UK pension assets (2023)

	£ trillion	% of assets
Private sector DB schemes	1.12	38%
Individual personal pensions	0.49	17%
Public sector funded DB schemes	0.49	17%
Contract based DC workplace schemes	0.31	11%
Annuities (Individual pension and bulk buy-out)	0.30	10%
Trust based DC workplace schemes	0.24	8%
Total value	**2.95**	**100%**

Source: Adapted from page 3 of Pension scheme assets – how they are invested and how and why they change over time, Pensions Policy Institute.

The value of private sector DB and DC assets is expected to converge over time. The Pensions Regulator (TPR) projects that by 2035 the value of assets that DB schemes will need to meet their obligations will have dropped to about £1.5 billion, while the value of assets in workplace DC schemes will have risen to about £1.3 billion.[14]

[13] Jackie Wells, Pension scheme assets – how they are invested and how and why they change over time, Pensions Policy Institute, September 2024, p3

[14] Mary Starks, Independent Review of TPR, figure 5; TPR Strategy: Pensions of the future, March 2021

2 Investment decision making

2.1 Who is responsible for investment decisions?

The investment decision-making structure differs in trust-based and contract-based schemes. In the former, trustees are responsible for decisions, based on advice. In the latter, the pension provider is responsible, with oversight from an independent governance committee (ICG). As trustees and ICGs are subject to similar requirements, the impact on investment choice relating to governance structure is negligible.[15]

Trust-based schemes

The trustee board retains ultimate responsibility for a scheme's investments, although they are required to "obtain and consider proper advice" in relation to their investments.[16] Although some large trust-based schemes have in-house investment teams, many delegate day-to-day decision-making to asset managers. This means that many trustees take investment decisions at a strategic level rather than in relation to individual investments.[17]

Trustees must make their investment decisions within a statutory framework. Particular requirements apply to the default arrangements used for auto-enrolment so that savers do not have to make an active choice of fund or how it is invested.[18] These include a cap on member-borne charges, of 0.75% of the fund.[19] In addition, trustees of schemes with more than 100 members are required to produce a Statement of Investment Principles (SIP) and to keep this under review. For default arrangements, the SIP should cover:

- The kinds of investment held;
- Investment in illiquid assets (from 1 October 2023);
- Risks, and how they are measured and managed;
- The expected return on investments;

15 PLSA, Pensions review: call for evidence. PLSA response, September 2024, para 3
16 Pensions Act 1995, s33-36
17 DWP, Considering social factors in pension scheme investments (PDF), March 2024
18 Pensions Act 2008, s17 (2) (b)
19 Occupational Pension Schemes (Charges and Governance) Regulations 2015 (SI 2015/879); DWP, The charge cap: guidance for trustees and managers of occupational schemes, 2 March 2015 (last updated 10 January 2022)

- How financially material considerations over the appropriate time horizon of the investments are taken into account, and the extent to which non-material factors are taken into account.[20]

Regulation

Different parts of the investment decision chain are subject to different regulatory regimes:

- Trustees fall within the remit of the Pensions Regulator (TPR), which is responsible for regulating the governance and administration of occupational pension schemes.[21] Its objectives include protecting pension scheme benefits and reducing the risk of claims on the Pension Protection Fund – the 'lifeboat' for DB scheme.[22] TPR has issued guidance on Investment governance in DC schemes.[23].

- Investment consultants only fall within the regulatory remit of the Financial Conduct Authority (FCA) if they give advice in relation to specific investments (regulated advice), not if they only give generic advice.[24] Strategic asset allocation advice and help with the process of selecting asset managers is not regulated.[25]

- Asset managers are regulated by the FCA.[26]

Contract-based schemes

Providers of contract-based schemes are required to operate an independent governance committee (IGC).

ICGs have a role similar to trustee boards. They were introduced from April 2015 following a report from the Office of Fair Trading which "revealed competition problems in the market, including a very weak buyer side and the potential for conflicts of interest." Addressing this was particularly important given the introduction of auto-enrolment from 2012, which entails workers being place in pension schemes which they have not chosen themselves.[27]

ICGs are required to:

---

20 Occupational Pension Schemes (Investment) Regulations 2005 (SI 2005/3378); TPR, Investment governance in DC schemes, (July 2016; updated August 2024)
21 Pensions Act 2004, Part 1
22 Pensions Act 2004, s5
23 The Pensions Regulator, Investment DC pension schemes, August 2024
24 Law Commission, Fiduciary Duties of Investment Intermediaries – Summary (PDF), July 2014, para 1.76
25 FCA, Asset management conduct study (PDF), MS15/2.2a, para 2.6
26 Financial Services and Markets Act (FSMA) 2000, Part 1A, Chapter 1; Memorandum of Understanding between the Financial Conduct Authority and The Pensions Regulator, April 2003
27 FCA website, Independent Governance Committees, 23 February 2016, updated 9 February 2023; Office of Fair Trading, Defined Contribution workplace pension market study, 2013

- Assess the ongoing value for money of workplace personal pension schemes, taking account of costs and charges, investment performance and quality of service;
- Act solely in the interests of relevant scheme members;
- Raise any concerns with the provider's board;
- Escalate their concerns to the FCA, if necessary; and
- Report annually on what they have done. [28]

Regulation

Contract-based schemes are largely regulated by the Financial Conduct Authority (FCA). The interaction between TPR and the FCA is complex. All workplace schemes must register with TPR, which oversees payments by employers into the scheme. However, FCA rules govern the way contract-based schemes conduct their business. [29]

2.2 The legal framework

Investment decisions are made within a complex legal framework, including:

- Agreements by the parties such as the contract entered into (or for trust-based schemes, the trust deed) which will often set out the powers and constraints on trustees.
- FCA rules, set out in its Conduct of Business Sourcebook, which are central to the way UK financial markets work.
- Pensions legislation, which differs for trust-based and contract-based schemes. For trust-based schemes, investment decisions are governed by the Pensions Acts 1995 and 2004.
- Case-law deriving from decisions in different areas of law - trusts, tort and contract.[30]

2.3 What factors drive decisions?

A key factor is the fiduciary duty. In broad terms, the fiduciary duty requires trustees to act in the best interest of scheme beneficiaries, as discussed in

[28] FCA, Conduct of Business Sourcebook (COBS) (PDF), section 19.5, August 2024

[29] Law Commission, The Fiduciary Duties of Investment Intermediaries, July 2014; Memorandum of Understanding between the FCA and TPR, April 2013

[30] Law Commission, The Fiduciary Duties of Investment Intermediaries - Summary, July 2014, para 1.15

section 5.1 of this paper. In line with this, a range of factors drive investment decisions:

- Member outcomes: What is needed to deliver these differs according to the nature of the scheme and the profile of its membership. For example, a mature defined benefit (DB) scheme with a high proportion of retired members needs a reliable income stream of the sort provided by bonds. The objective for DC providers is to try to maximise the chance of investments performing well over the course of people's working life to give them as large a pension pot as possible.[31]

- Performance cost and accessibility of assets: In determining how to allocate assets, trustees and their advisers will model the expected returns and volatility of different types of assets. Liquidity (the degree to which an asset or security can be quickly bought or sold in the market with minimum price disturbance) is also a factor.

- Government and regulatory policy: For DC schemes, the Government plans to introduce a VFM framework, providing a standardised test (relating to investment performance, costs and charges and quality of services) that schemes will have to meet to demonstrate that they deliver value.[32]

- Size of scheme: larger schemes are more likely to have in-house investment teams, allowing them to move away from pooled funds to manage direct investment in assets and to develop a more diverse investment portfolio.

- Sustainability and climate change – increasingly trustees weigh up longer-term risks and returns related to climate change issues.[33]

Market performance is a key factor in driving investments, as is the "highly advisable" need to achieve diversification, which is "best achieved by a broad allocation across global markets."[34]

---

[31] ABI, Investing in our future: delivering for savers and the economy (PDF), July 2023

[32] The Prime Minister's Office, Kings Speech 2024 – background briefing (PDF), July 2024

[33] Adapted from Jackie Wells, Pension scheme assets – how they are invested and how and why they change over time (PDF), PPI, September 2024, p4

[34] Society of Pension Professionals, Society of Pension Professionals response to the Pensions Investment Review: Call for Evidence, (PDF), September 2024, para 2.6; APPT, APPT response to Pensions Investment Review, September 2024

3 How do schemes invest their assets?

The PPI points to gaps in our understanding of how pension fund assets are invested, partly because multiple datasets classify assets in differently and relate to different points in time. Furthermore, definitions overlap (for example, investment in infrastructure can take the form of an equity share). Many schemes invest in pooled funds (in which assets from different asset owners are aggregated) and seeing through these to the underlying investment is not straight forward. Defining a UK versus overseas asset was also “fraught with difficulty.” The PPI recommended that government and regulators work with the industry to agree on a standard set of categories and definitions. [35]

Described by DWP as an “important step towards transparency, standardisation and comparability,” from April 2023, regulations have required trustees of occupational DC pension schemes to disclose the percentage of assets in their default funds that are allocated to specified asset classes:

- cash
- bonds issued by a company or government
- listed equities - shares listed on a recognised stock exchange
- private equity (that could include venture capital and growth equity)
- infrastructure
- property/real estate (property which does not fall within the above)
- private debt/credit not covered by bonds
- any other assets.[36]

In its August 2024 consultation on a value for money framework, the FCA proposed applying the same requirements to contract-based arrangements. In addition, it proposed requiring the disclosure of several sub-asset classes, including “different bond types, types of listed and private equities, as well as the split between listed/unlisted assets and UK/non-UK assets”, setting out

[35] Jackie Wells, Pension scheme assets – how they are invested and how and why they change over time, Pensions Policy Institute, September 2024, p8-9

[36] DWP, Statutory guidance: Disclose and Explain asset allocation reporting and performance-based fees and the charge cap, 30 January 2023

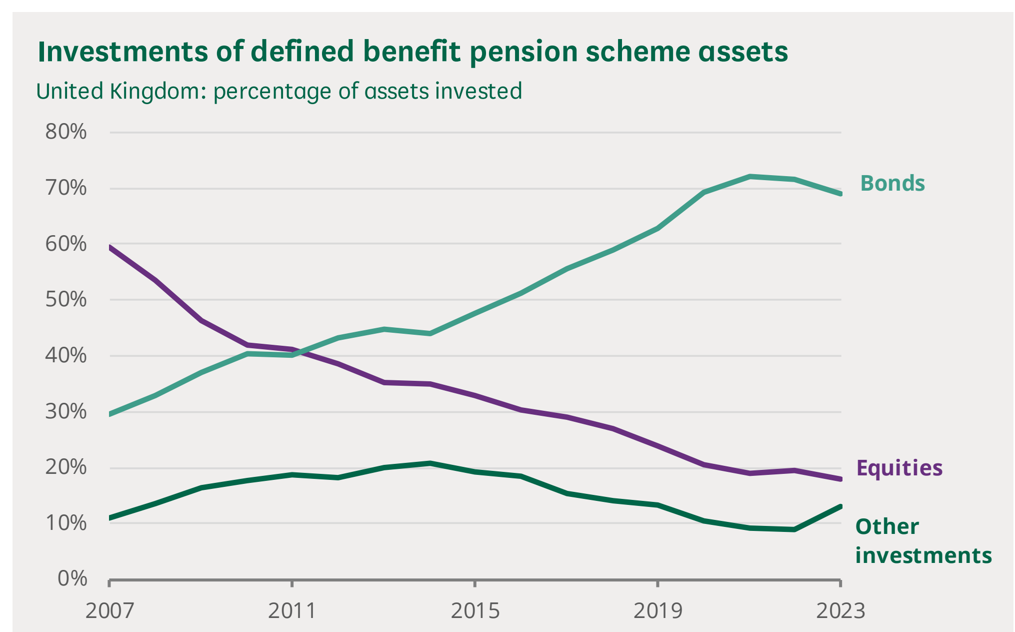
proposals on how these might be defined. To avoid double-counting, it proposed that firms should follow the primary purpose of the investment.[37]

3.1 Asset allocation by scheme type

According to the PPI of the £3 trillion of UK pension assets, approximately one third are invested in listed equities, 38% in bonds and 10% in alternatives.[38] Asset allocation varies significantly by type of pension scheme.

Private sector defined benefit schemes

Private sector DB scheme investment is now dominated by bonds. This was not always the case. In 2006, when TPR and the Pension Protection Fund started to publish figures, 61.1% of DB scheme assets were invested in equities and 28.3% in bonds and 10% in other asset classes (cash, property, annuities etc). By 2023, the proportions were 68.9% invested in bonds, 18.0% equities and 13.1% in other asset classes.[39]



Source: PPF The Purple Book

[37] FCA, The value for money Framework, Consultation Paper CP 24/16 (PDF), August 2024, para 5.5-17

[38] PPI, Pension scheme assets – how they are invested and how and why they change over time, September 2024, p14

[39] TPR and PPF, Purple Book 2023 (PDF), chapter 7

The PPI has a lower estimate of the proportion invested in bonds (55%), based on the ONS' Financial Survey of Pension Schemes, which is more up to date.[40]

The dominance of bonds reflects the fact that almost three quarters (72%) of DB schemes are closed to future build-up of benefits. This means they are maturing, with more of their members drawing pensions and a relatively short time horizon over which the scheme expects to keep paying them. Bonds are a suitable investment for such schemes because they provide a reliable stream of income, which can be relied on to pay pensions as they fall due, without calling on the sponsoring employer for additional funds. This is in line with regulatory policy (another important driver of investment strategies).[41]

DB schemes that are open to new members are in a different position. They have a flow of new members and contributions to help pay pensions and longer time horizons for paying them. This enables them to invest in 'growth assets', which are expected to provide a greater return on capital but are also seen as a greater risk.[42] Although only 4% of private sector DB schemes are open, they are still a significant part of the landscape with 1.2 million members and £165 billion in assets under management.[43] One of the large remaining open schemes = the Universities Superannuation Scheme (USS) - invests over half (57%) of its £75.5 billion in 'growth assets' (investments expected to deliver capital growth and/or variable/dividend income over time), including public and equities, infrastructure, real estate and commodities.[44] Another – the Railway Pension Schemes – invested approximately £6.5 billion in productive finance assets at the end of 2022.[45]

Defined Contribution

The PPI found it more difficult to map DC asset allocation, as no single source of data exists and a minority of members (10%) adopt a self-select approach to investment. Extrapolating for ONS data on the investments of trust-based schemes, PPI estimates that just over half of the £1 trillion of assets in DC schemes are in listed equities (£585 billion), just under a quarter (24%) in bonds, three percent in alternatives and 17% in cash and other.[46] Based on its own survey, it found that although DC investment remained heavily focused in

40 Jackie Wells, Pension scheme assets – how they are invested and how and why they change over time, Pensions Policy Institute, September 2024, p12. The alternatives category includes private equity, property, secure income alternatives, infrastructure, private debt and venture capital.

41 Work and Pensions Committee, Defined benefit pension schemes with Liability Driven Investments, HC 826, June 2023, para 34 and 41

42 Jackie Wells, Pension scheme assets – how they are invested and how and why they change over time, Pensions Policy Institute, September 2024, p12

43 TPR, Occupational defined benefit landscape in the UK 2023, Figures 1, 4 and 6

44 USS/how we invest/where we invest (viewed November 2024); 'Growth assets', such as shares or property, typically provide returns in the form of capital growth but are often considered higher risk because their value fluctuates over time

45 Work and Pensions Select Committee, Defined benefit pension schemes (PDF), HC 144 2023-24, July 2023, ev 81

46 Jackie Wells, Pension scheme assets – how they are invested and how and why they change over time, Pensions Policy Institute, September 2024, page 13-14

equities and bonds, small allocations to alternative asset classes (such as cash, infrastructure, property and real estate) were increasing.[47]

Regulatory requirements on DC schemes include those relating to the default arrangements for auto-enrolment schemes, which should achieve an appropriate balance between risk and return for the likely membership profile.[48] Trustees needed to consider member borne costs and charges (which must not exceed a cap of 0.75% of assets under management) as part of their assessment of value for money.[49]

Annuities

According to the PPI, the pension annuity business, another important part of the UK pensions sector, with assets of approximately £300 billion, is 25% invested in government bonds, 30% in corporate bonds, 40% in residential mortgages and loans and 5% in other assets.[50]

3.2 To what extent are UK pension funds invested in the UK economy?

Productive finance does not have a legal definition but is often described as "investment that expands productive capacity, furthers growth and can make an important contribution to the real economy." Examples include "plant and equipment (which can help businesses achieve scale), research and development (which improves the knowledge economy technologies, for example green technology), infrastructure, private equity related to these sectors."[51]

The PPI arrived at different estimates of the extent to which UK pension fund assets invested in productive finance, depending on the definition used:

- Under a narrow definition - limited to private equity and other alternative investments - an estimated 6% (or £191 billion).
- Including allocation to UK listed equities - an estimated 5% or £148 billion- would take the proportion to 12%.

---

47 PPI, The DC Future Book 2024, September 2024, p26

48 DWP, Guidance for offering a default option for defined contribution automatic enrolment pension schemes (PDF), May 2011

49 TPR, Default arrangements and charge restrictions, 28 March 2024; Occupational Pension Schemes (Charges and Governance) Regulations 2015 (SI 2015/879); FCA, PS 15/5 Final rules for charges in workplace personal pension schemes and feedback on CP 14/24, 30 August 2015

50 PPI, Pension scheme assets – how they are invested and how and why they change over time, September 2024, p14

51 DWP, Consultation on Options for Defined Benefit schemes, March 2024, footnote 3

- If an estimated 7% or £201 billion of assets allocated to corporate bonds is also included, this takes the estimated proportion to 18%.[52]

Overall, PPI estimates that £541 billion (18%) of UK pension assets is invested in UK business.[53] Its analysis revealed that:

- The biggest investors in UK corporate bonds were private sector DB schemes and annuity providers.
- Public sector DB schemes are the largest investors in UK productive assets overall.
- Private and public sector DB schemes are the largest investors in alternatives by value, but public sector schemes invest a higher proportion of assets.
- DC (workplace and individual included here) is a relatively small investor in the UK, with listed equities being the largest category.[54]

PPI concluded that the government's ambitions for more investment in private equity would need to be driven by open DB and DC schemes. If asset allocation was to be tracked, government and regulators would need to ensure consistent and comprehensive definitions.[55]

3.3 How does this compare internationally?

Politicians sometimes refer to pension schemes in Canada and Australia as models to follow. In his 2023 Mansion House speech, the then Chancellor of the Exchequer, Jeremy Hunt, referred to that fact that UK DC schemes invested under 1% in unlisted equities, compared to between 5 and 6% in Australia.[56] The current Chancellor of the Exchequer, Rachels Reeves, has said she wanted the UK to learn lessons from Canada, where the 'Maple 8' group of Canadian retirement funds had "invested billions of pounds in the UK economy in recent years."[57]

Analysis by the think tank New Financial suggests that although Canadian pension schemes may invest in the UK economy, they are comparatively at the low end when it comes to investing in their own domestic market. Australian pension funds invest more domestically, a direct result of tax credits to

---

52 Jackie Wells, Pension scheme assets – how they are invested and how and why they change over time, Pensions Policy Institute, September 2024, p15

53 Jackie Wells, Pension scheme assets – how they are invested and how and why they change over time, Pensions Policy Institute, September 2024, p15

54 As above

55 PPI, PPI press release, 9 September 2024; See also, Bank of England, Understanding and measuring finance for productive investment – A Discussion Paper, 8 April 2016, section 5

56 HM Treasury, Chancellor Jeremy Hunt's Mansion House speech, 10 July 2023

57 HM Treasury, Chancellor Reeves: Pension funds can fire up the UK economy, 7 August 2024

Australian investors on dividends paid by UK companies. New Financial found a wide variation internationally in the extent to which pension schemes invested in their domestic markets:

- At the bottom end, there were five markets with around 5% or less allocated to domestic equities, including the UK, Canada and Norway.
- A middle group including Sweden and Switzerland, allocated 10%.
- At the top end, Australia, Hong Kong and Japan allocated 20% or more. Excluding the US (on the basis that the US stock market represents nearly two-thirds of the global index), the weighted average allocation to domestic equities in the sample was just over 10%.[58]

New Financial estimated that, overall, UK pension funds allocated 4.4% of their assets to UK equities. However, this disguised big differences between the main 'buckets' of pensions in the UK: private sector DB schemes allocated just 1.4% to UK equities, public sector DB 9% and DC around 8%.

Comparing the different types of UK pensions with the most relevant pensions in other systems, New Financial found that "each part of the UK pension system has a lower allocation to domestic equities as a percentage of their total assets, as a proportion of their total allocation to equities and relative to the size of the local stock market, than the global weighted average (excluding the US) of the pension systems [it] analysed." It concluded that "UK pensions could significantly increase their allocation to domestic equities and still be comfortably in line with their historic norms and with pension funds in other markets."[59]

58 William Wright and James Thornhill, Comparing the asset allocation of global pension systems (PDF), New Financial, September 2024, p3, 7 and 20

59 As above

4 Investment in the UK economy

4.1 The 2024 pensions investment review

On 16th August, the government announced the terms of reference its Pensions Investment Review, to be led by Minister for Pensions, Emma Reynolds. It would explore the potential to "increase net investment in UK asset classes such as unlisted and listed equity and infrastructure, and the potential impacts of such an increase on UK growth."

An interim report was published on 14 November 2024.[60]

Call for evidence August 2024 and defined contribution schemes

Relevant to DC schemes, the review would focus on:

- Driving scale and consolidation of DC workplace schemes;
- The structure of the pensions ecosystem and achieving a greater focus on value to deliver better outcomes for future pensioners, rather than cost; and
- Encouraging further investment into UK assets to boost growth across the country.[61]

Ongoing policy development with respect to defined benefit (DB) schemes (which provide benefits based on salary and length of service) would remain separate from the review.[62]

The government published a call for evidence on 4 September 2024, focused on consolidation and value for money, with responses requested by 25 September 2024. It is to report later this year, ahead of the introduction of the Pension Schemes Bill announced in the Kings' Speech.[63] In a speech to the ABI

60 Department for Work and Pensions, Pensions Investment Review: Unlocking the UK pensions market for growth, 14 November 2024

61 HM Treasury, Department for Work and Pensions, Ministry for Housing, Communities and Local Government (MHCLG), Pensions Review - Terms of Reference, 16 August 2024; HM Treasury, DWP and Ministry of Housing, Communities and Local Government, Pensions Investment Review: Call for Evidence, September 2024

62 As above

63 HM Treasury, DWP, MHCLG, Pensions Review - Terms of Reference, 16 August 2024; Prime Minister's Office, 10 Downing St, King's Speech 2024: background briefing notes, 17 July 2024

on 3 October, Pensions Minister, Emma Reynolds, said the intention was to "publish an interim report in the autumn with the full recommendations from phase one to be published next year."[64]

What change did the Government want to see?

In developing its recommendations, the government's review will have regard to a range of issues, including:

- Boosting the returns for pension savers;
- The role of pension funds in capital and financial markets to boost returns and UK growth;
- Any implications for wider financial stability policy objectives such as with respect to the gilt market.[65]

The Pensions Minister has two overarching objectives: increasing pension investment in "UK productive assets" to support UK businesses and "improving retirement outcomes for future pensioners."[66]

The government's call for evidence asked for views on the main factors behind changing patterns of UK pension fund investment in asset classes, including UK-listed equities. It asks whether there is a case for establishing additional incentives or requirements aimed at raising the portfolio allocations of DC funds to UK assets or particular UK asset classes, taking account of the aim to improve saver outcomes and boost UK growth.[67]

Supporting pension scheme investment in UK productive assets was also a goal of the previous government, with the aim of benefiting members and the broader economy.[68] Productive finance does not have a legal definition but is often described as "investment that expands productive capacity, furthers growth and can make an important contribution to the real economy." Examples include "plant and equipment (which can help businesses achieve scale), research and development (which improves the knowledge economy technologies, for example green technology), infrastructure, private equity related to these sectors."[69]

Investments of this sort can be less "liquid" - liquidity referring to the "degree to which an asset or security can be bought or sold in the market with minimum price disturbance." Private market assets (investments in the capital of privately owned structures) often cannot easily or quickly be converted to cash. In general, they are long-term investments accessed via

[64] DWP, 'Delivering better outcomes for our future pensioners', Emma Reynolds speech to ABI, 3 October 2024

[65] HM Treasury, DWP, MHCLG, Pensions Review - Terms of Reference, 16 August 2024

[66] DWP, Delivering better outcomes for our future pensioners, Emma Reynolds speech to ABI, October 2024

[67] HM Treasury, DWP, MHCLG, Pensions Investment Review: Call for Evidence, 4 September 2024

[68] DWP, Consultation on Options for Defined Benefit schemes, March 2024, footnote 3

[69] DWP, Consultation on Options for Defined Benefit schemes, March 2024, footnote 3

closed-ended structures and can take years to realise for cash. Attempting to sell before maturity may mean selling at a discount. It may also be more challenging to value the investment, compared to an investment in a publicly listed company.[70]

Reflecting these challenges, an “illiquidity premium” (higher return) generally attaches to such investments. However, they also place a higher reliance on the pension fund’s oversight and governance to mitigate the additional risks that may arise. Pressures resulting from low market returns following the global financial crisis, had fuelled interest in these new alternative forms of investment.[71]

Interim report November 2024

The government published an interim report to the pensions investment review on 15 November 2024.[72] Following the interim report, the government sought further views on proposals to increase scale and consolidation including:

- Introducing minimum size requirements for default funds used in multi-employer schemes for automatic enrolment (see section 1.1)
- Limiting the number of multi-employer default funds
- Allowing disengaged contract-based scheme members’ pensions to be transferred without their consent to better performing arrangements.[73]

The interim report looked at how pension fund investments could support UK economic growth. The report notes that domestic investment by UK pension schemes is lower compared to large Canadian and Australian schemes. While proposed reforms aim to scale schemes and enable investment in productive assets like infrastructure and private equity, no specific recommendations on UK-focused investment have been made yet. The review’s next phase will assess whether further government action is needed to ensure the anticipated growth in pension fund assets supports the UK economy.[74]

The interim report also set out proposals for the local government pension scheme on pooling assets and strengthening governance for consultation.[75]

---

[70] The Pensions Regulator, Funding and investment: detailed guidance/Private markets investment, 24 January 2024

[71] Nick Hurman, Pension scheme assets – a deep dive into alternatives (PDF), Pensions Policy Institute, September 2024

[72] DWP, Pensions Investment Review: interim report, consultations and evidence, 14 November 2024

[73] As above, para 1.7

[74] As above, paras 4.1-4.12

[75] As above, para 2.1-2.15

4.2 Background

Concern about the extent to which UK pension scheme investments support economic growth is not new. Successive governments have expressed a desire to see UK pension funds invest in a way that has potential to both deliver better outcomes for pension savers and support growth in the UK economy (placing differing emphasis on what form they want this to take). A succession of reviews has identified potential barriers. These have included:

- A Review of Equity Markets by Professor John Kay, set up in 2011 by the then Business Secretary, Vince Cable.[76]
- A Patient Capital Review, set up in 2017: led by HM Treasury, with input and advice from an industry panel chaired by Sir Damon Buffini.[77]
- A Productive Finance Work Group, industry-led and co-chaired by the Governor of the Bank of England, the Chief Executive of the FCA and the Economic Secretary to the Treasury, this reported in September 2021.[78]
- In November 2021, DWP consulted on proposals to remove performance-based fees from the charge cap applying to auto-enrolment schemes, with the aim of enabling DC schemes to access a broader range of illiquid asset classes.[79]
- The Mansion House speech in 2023 from the then Chancellor, Jeremy Hunt, accompanied by consultations on DB scheme consolidation, value for money and trustee capacity.[80]

Key issues explored in these reviews include the way fiduciary duties are interpreted, the fragmented nature of the pensions market, and a tendency of trustees to over-focus on cost rather than value.

[76] HC Deb 22 June 2011 c14WS; Department for Business Innovation and Skills, The Kay Review: terms of reference (PDF), June 2011; Department for Business, Innovation & Skills, The Kay Review of UK Equity Markets and Long-Term Decision Making. Final Report (PDF), July 2012

[77] HM Government, Patient Capital Review Policy Paper, published 23 January 2017, updated 22 November 2017

[78] Productive Finance Working Group, A roadmap for increasing productive finance investment (PDF), September 2021

[79] DWP, Enabling investment in productive finance, 30 November 2021

[80] HM Treasury, Chancellor Jeremy Hunt's Mansion House speech, July 2023; DWP, FCA and TPR, Value for Money: A framework on metrics, standards and disclosures, 30 January 2023 to 25 July 2023; DWP, Government response: Consolidation of defined benefit pension schemes, July 2023; DWP and HM Treasury, Pension trustee skills, capability and culture: a call for evidence, July 2023

4.3 Fiduciary duties

For trust-based schemes, a common question is how pension scheme trustees should take investment decisions in line with their 'fiduciary duties.' These duties stem from the fact that they have undertaken to act on behalf of others. Their starting point must be the purpose of the trust, which is to pay pensions to the beneficiaries and they must put the interests of the beneficiaries before their own. [81] In fact, fiduciary duties do not just apply to trustees. They apply to people who undertake to act on behalf of another in a particular matter – so, for example, also to investment consultants and asset managers. Similar considerations apply to managers of contract-based schemes because the interests of their members are similar and the government intends such schemes to provide similar levels of protection).[82]

The Kay review of UK equity markets, 2012

A recurrent issue is how trustees interpret their fiduciary duties and whether they pay disproportionate attention to the short-term and to costs and not enough to considering longer term risks and returns. In a 2012 review of equity markets for the Coalition Government, Professor John Kay concluded that "short-termism was a problem in UK equity markets" and that this was caused by a decline of trust and misaligned incentives throughout the investment chain. Recommendations included the development of a Stewardship Code, focusing on strategic issues as well as corporate governance, and asking the Law Commission to clarify the application of the legal concept of fiduciary duty as applied to investment to address uncertainties and misunderstandings on the part of trustees and their advisers.[83]

Law Commission report, 2014

In its report, published in 2014, the Law Commission said that the law was complex and that uncertainty about how to interpret it, led to trustees taking insufficient account of environmental, social and governance factors. To clarity matters, the Law Commission proposed a "key distinction" between:

- "Financial factors", defined as any factor "relevant to the pension fund trustees' primary investment duty of balancing returns against risks";
- "Non-financial factors", motivated by other concerns, such as improving member's quality of life or showing disapproval of certain industries.

[81] Financial Markets Law Committee, Pension Fund Trustees and Fiduciary Duties – Decision making in the context of Sustainability and the subject of Climate Change, 8 February 2024

[82] Law Commission, The Fiduciary Duties of Investment Intermediaries - Summary (PDF), July 2014, para 1.28; Pensions Investment Review – PLSA response, (PDF) September 2024

[83] Department for Business, Innovation & Skills, The Kay Review of UK Equity Markets and Long-term Decision Making. Final Report (PDF), July 2012

It said that trustees could take account of non-financial factors, if they; had good reason to think scheme members shared the concern; and the decision would risk significant financial detriment to the fund.[84]

DWP call for evidence, July 2023

In its July 2023 call for evidence on Pension trustee skills, capability and culture, DWP asked whether the existing framework and guidance on fiduciary duty was sufficient to help trustees make decisions in the best long-term interest of savers. In addition, it asked whether legal advice on investments contributed to a culture of risk aversion.[85]

The majority of respondents to the Call for Evidence agreed that fiduciary duties were a well-established and well-understood concept by both professional and lay trustees and that any policy intervention from government to change fiduciary duty would be undesirable. The majority also said that trustees made investment decisions in the long-term interests of savers, although this could be supported by further guidance. Due to the competitive nature of the DC market, evidence suggested that some trustees focused on short-term performance and minimising costs and charges.[86]

Financial Market Law Committee, February 2024

In February 2024, the Financial Markets Law Committee set out to clarify how fiduciary duties apply in investment decision-making, particularly in balancing risk and return in relation to climate change issues.[87] It explained that risks that might previously have been seen as non-financial, now needed to be recognised as financial. Trustees should reject shorter-term financial gains if these led to longer-term risks to financial returns and it was important for them to exercise their stewardship role in the economy.[88]

Advisers and others

A further concern has been how to ensure the right principles apply throughout the decision-making chain. Others are involved: trustees are required to take investment advice, for which many use investment consultants, and may delegate day to day investment decision making to asset managers.[89]

---

84 Law Commission, The Fiduciary Duties of Investment Intermediaries – Summary (PDF), 2014; As recommended by the Law Commission, the Government amended the Occupational Pension Schemes (Investment) Regulations (SI 2005/3378), reg 2, to reflect these recommendations

85 DWP, Pension trustee skills, capability and culture: a call for evidence (PDF), July 2023, chapter 3

86 DWP, Government response to 'Pension trustee skills, capability and culture: a call for evidence (PDF), 22 November 2023

87 Financial Markets Law Committee, Pension Fund Trustees and Fiduciary Duties: Decision-making in the context of Sustainability and the subject of Climate Change (PDF), 6 February 2024

88 Work and Pensions Committee, Written evidence to the Work and Pensions Committee from the UK Sustainable Investment and Finance Association (PDF), March 2024

89 Pensions Act 1995, s34-6

The 2012 Kay review stressed the importance of all participants in the investment chain acting according to the principles of stewardship and observing fiduciary standards in their relationships with customers. Market incentives needed to enable and encourage all participants to adopt investment approaches which achieved long-term returns.[90]

The Law Commission considered whether rules needed to be revised to raise behaviour to fiduciary standards or encourage a longer-term. It noted that investment consultants were regulated when they advised on specific investments but not where they gave 'generic' advice, for example to trustees on their investment strategy. However, as no specific risk from this had been identified, it did not recommend extending regulation in this area.[91]

In 2022, the FCA identified weaknesses in the advice investment consultants gave to trustees in relation to their use of Liability Driven Investments (LDI). In some cases, they gave standardised advice, rather than "thinking through in depth and detail what might be the right thing for each pension fund."[92] The FCA's call for investment consultants to be bought within its remit was supported by the Bank of England's Financial Policy Committee.[93]

In its 2024 report, the Financial Markets Law Committee stressed the fact that responsibility for decision-making rested with the trustees and that it was important that they were able to challenge their advisers.[94]

Is there a role for mandation?

Both the current Labour Government and the previous Conservative Government encouraged more investment by UK pension funds in the economy and indicated a willingness to consider further action if this does not follow.

In July 2023 his Mansion House Speech, the then Chancellor of the Exchequer, Jeremy Hunt, described it as a "perverse situation in which UK institutional investors are not investing as much in UK high-growth companies as their international counterparts". In particular, he highlighted the low level of investment in "unlisted equity" (1%), compared to between 5 and 6% in Australia. To address this, he announced that, the CEOs of many of the largest DC schemes had signed up to the "Mansion House Compact", which had the objective of allocating at least 5% of their default funds to unlisted

[90] Department for Business, Innovation & Skills, The Kay Review of UK Equity Markets and Long-Term Decision Making. Final Report, July 2012, Executive Summary

[91] Law Commission, Fiduciary Duties of Investment Intermediaries. Executive Summary (PDF), July 2014, para 1.72-79

[92] Work and Pensions Committee, Defined benefit pensions with liability-driven investment (PDF), 14 December 2022, HC 826 2022-23, Q204

[93] Economic Affairs Committee, Letter from FCA Chief Executive to Chairs of the House of Lords Industry and Regulators and Economic Affairs Committee (PDF), 20 October 2022; Bank of England Financial Policy Committee, Financial Stability Report - December 2022, 13 December 2022

[94] Financial Markets Law Committee, Pension Fund Trustees and Fiduciary Duties: Decision-making in the context of Sustainability and the subject of Climate Change (PDF), 6 February 2024, section 3

equities by 2030."[95] It was calculated that this could unlock £50 billion of investment in high growth companies, although the commitment did not lock in providers to invest in the UK.[96] In his Spring 2024 Budget, the then Chancellor said the government would consider "further action" if the data did not demonstrate that UK equity allocations were increasing.[97] A one-year on report from the ABI said that signatories to the Compact had made significant strides towards its aims.[98]

In its pensions investment review, the current Labour Government has asked whether there is a case for additional incentives or requirements aimed at raising the allocations of DC funds to UK assets, or particular UK asset classes.[99]

Comment

Fiduciary duties

The pensions industry has expressed concern about the suggestion that schemes might be mandated to invest in specific asset classes, arguing that the focus should instead be on creating the right environment, incentives and investment vehicles to enable it. [100]

The PPI said that organisations it interviewed as part of its research on investment, "expressed strong views on any Government move to mandate where funds are invested. Several felt that additional incentives to make UK investment more attractive for scheme members, such as tax changes, might be needed to encourage greater investment in the UK."[101]

The Association of Professional Pension Trustees (APPT) made the point that allocations to UK equities had been in "steady decline across virtually all investment strategies for the better part of a decade." This was because "their performance, costs and risk profile are not competitive when compared to the global market." For pension schemes to increase their investment in domestic assets, they would need to be more attractive.[102]

On 24 October 2024, Governor of the Bank of England, Andrew Bailey, was reported as saying that he did "not for a moment support a compulsory allocation of pension money to UK assets." Chancellor, Rachael Reeves said

---

95 HM Treasury, Chancellor Jeremy Hunt's Mansion House speech, 10 July 2023

96 Nick Furman, Pension scheme assets – a deep dive into infrastructure, Pensions Policy Institute, October 2024

97 HM Treasury, Spring Budget 2024, 6 March 2024, para 4.28

98 ABI, The Mansion House Compact. Year one progress update, July 2024

99 HM Treasury, DWP, MHCLG, Pensions Investment Review: Call for Evidence, 4 September 2024

100 PLSA, PLSA response to Pensions review: call for evidence (PDF), September 2024; Society of Pension Professionals response to the Pensions Investment Review: Call for Evidence, September 2024, para 2.6

101 PPI, How pension scheme assets are invested, September 2024; ABI Pensions Investment Report, 2023

102 APPT, Response to Pensions Investment Review, 25 September 2024

she wanted to see consolidation, “not through mandating but through being much clearer around the obligations” to deliver for savers.[103]

Changes to support UK investment

In its response to the pensions investment review, the ABI said that for pension schemes to have bias towards domestic investments, they would need to deliver “better financial outcomes for savers in the long term.” A “stable and predictable political and regulatory environment” was needed to provide certainty for pension schemes to invest long term. [104] It supported the development of Long-Term Asset Funds (LTAF) structured to manage the risks throughout the economic cycle, including during stressed market conditions, and allow asset sales in an orderly manner without a discount.[105] However, these remained expensive and had a lengthy approval process which was cumbersome.[106]

The PLSA has called for:

- Suitable investment opportunities: a “rich and continuous pipeline of enterprises needing investment.” The asset management industry should focus on sourcing UK opportunities and developing investment funds and products (such as LTAFs) appropriate to pension fund needs. The British Business Bank could partner with pension schemes to support companies that need scale-up capital.
- Fiscal incentives: enhancing the tax treatment of domestic investments, as they do in France and Australia, merits exploration.
- Policy certainty: setting out a clear plan for the future of the UK economy, for example by setting out an industrial strategy for key tasks like the green transition.[107]

4.4 Value for Money

The introduction of auto-enrolment made it particularly important to ensure workplace pension schemes delivered value for money. This was because employees did not play a part in choosing the fund they were auto enrolled into and employers, who did choose the scheme, often lacked the capability or incentive to ensure employees received value for money. In 2013, the Office

[103] Don’t force pension giants to invest in Britain, urges Bailey, The Telegraph, 24 October 2024
[104] ABI, ABI response to Pension Investment Review – Call for Evidence, September 2024
[105] Productive Finance Working Group, A roadmap for increasing productive finance investment (PDF), September 2021
[106] ABI, The Mansion House Compact. Year one progress update (PDF), July 2024
[107] PLSA, Pensions and Growth (PDF), June 2023; PLSA, PLSA response to Pensions Investment Review, September 2024

of Fair Trading found competition in the DC workplace pensions market to be "one of the weakest it had analysed in recent years."[108]

The charge cap

Following the OFT report, the Coalition Government introduced a cap on charges applying to the default arrangements for DC schemes used for auto-enrolment from April 2016. The cap was set at 0.75 per cent of funds under management.[109] The reason for this was that charges could have a significant impact on the value of a pension pot over time.[110]

Performance fees

In 2021, the Productive Finance Working Group identified a need to shift the focus from cost to long-term value. It recommended that DC scheme decisions makers actively consider how increasing investment in less liquid assets could generate better value for members. It said asset managers and DC schemes should identify a way to accommodate, within the charge cap, the higher performance fees associated will illiquid investments.[111]

In November 2021, DWP consulted on changes to the way in which performance fees were taken into account for the purposes of the cap on charges that applies to the default funds of schemes used for auto-enrolment.[112] Regulations to increase flexibility for DC schemes to take account of performance fees were introduced in 2021.[113]

Consultation on value for money

One of the priorities of the Pensions Regulator's current corporate strategy is to develop a value for money framework so that all savers receive value from their pensions.[114]

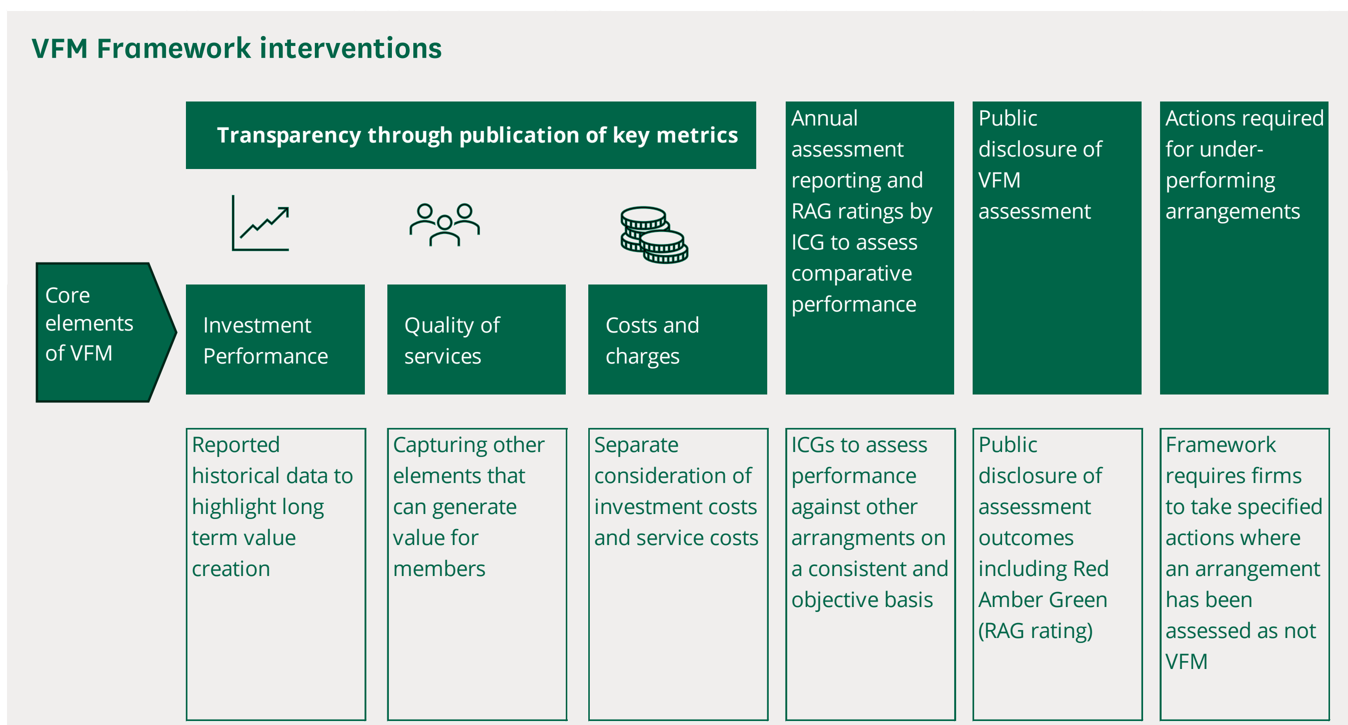
In July 2023, DWP and the regulators consulted on a value for money (VFM) framework on metrics, standards, and disclosures. The VFM framework would provide a standardised test (relating to investment performance, costs and

[108] OFT, Defined Contribution workplace pension market study, 2013
[109] The Occupational Pension Schemes (Charges and Governance) Regulations 2015 (SI 2015/879)
[110] DWP, Better pensions: a consultation on charging (PDF), Cm 8737, October 2013
[111] Productive Finance Working Group, A roadmap for increasing productive finance investment, September 2024, Executive Summary, para 8
[112] DWP, Enabling Investment in Productive Finance. Policy consultation on proposals to remove performance-based fees from the charge cap (PDF), November 2021; DWP, Facilitating investment in illiquid assets (PDF), March 2022; DWP, Incorporating performance fees within the charge cap, March 2023
[113] Occupational Pension Schemes (Administration, Investment, Charges and Governance) (Amendment) Regulations 2021 No 1070
[114] TPR, Corporate Plan 2024 to 2027, May 2024

charges and quality of services) that schemes would have to meet to demonstrate that they deliver value.[115]

In August 2024, the FCA launched a consultation on the VFM framework as it would apply to the default arrangements of workplace contract-based DC schemes. The government had said it would introduce measures to apply the Framework to trust-based schemes in the forthcoming Pension Schemes Bill.[116]

The intention is that, by promoting a focus on key metric performance indicators, the VFM framework would challenge those managing schemes to reflect on value to improve saver outcomes. Schemes not delivering VFM would be required to take action:[117]



Source: adapted from FCA, The value for money Framework (CP24/16), p11

The VFM framework would introduce four elements. It:

- Requires the consistent measurement and public disclosure of investment, performance, costs and service quality;
- Enables those overseeing and challenging an arrangement's value to assess performance against other arrangements on a consistent and objective basis;

115 DWP, FCA, TPR, Value for Money: A framework on metrics, standards, and disclosures. Consultation on policy (PDF), 30 January 2023, chapter 1
116 10 Downing St, The King's Speech 2024 – background briefing notes, July 2024, p14
117 FCA, The value for money Framework (CP24/16) (PDF), para 1.17 and 2.12

- Requires public disclosure of assessment outcomes including a Red Amber Green (RAG) VFM rating for each arrangement;
- Requires firms to take specified actions where an action has been assessed as not VFM (Red or Amber).[118]

The FCA anticipates that the pressure on firms, together with the availability of objective performance-based data to employers, to drive competition based on value rather than predominantly cost. The result should be "larger pension pots for savers at retirement." It says the Framework also has the potential to support UK growth, by supporting "consideration of a broader range of asset classes, including illiquid investments that have the potential to improve risk-adjusted returns over the longer term." It will also highlight how much default arrangements invested in UK equities.[119] However, it acknowledges the potential for unintended consequences, such as the risk of "herding", as providers make changes to stay close to the "average" of what is being measured to avoid being penalised for underperformance."[120]

Comment

The PLSA says that in a consolidating and competitive market, the focus on employers and savers was on charges. As a result, charge levels in default funds were low, such that incorporating significant amounts of illiquid investments into them was not achievable. There was no "silver bullet" to change the structure of the market, but more attention needed to be paid to changing employer behaviours and choices. Changes to TPR guidance to focus more on value for money and member outcomes would be welcome.[121] The ABI also highlighted its support for driving better returns for savers.[122]

The Society of Pension Professionals agreed that a focus on cost by employers and advisers selecting DC workplace schemes had reduced charges and that they were now at a level where they generally stifled investment innovation. Clearer and more transparent reporting through value for money metrics could help.[123]

The Association of Professional Pension Trustees said the focus on costs was understandable because they were borne by members. However, the current approach did restrict investment in higher fee asset classes. This could be addressed by looking at the structure of the cap. In addition, it would be important to review the VFM framework to ensure that it did not have the unintended consequence of discouraging investment in private markets through an excessive focus on short term performance. While private markets

---

118 FCA, The value for money Framework (CP24/16) (PDF), para 1.5

119 As above, para 2.12-18

120 As above, para 2.34

121 PLSA, Response to Pensions Investment Review, September 2024

122 ABI, ABI publishes its response to the FCA's value for money Consultation, 17 October 2024

123 SPP, Response to Pensions Investment Review (PDF), September 2024

were expected to outperform over the long-term, they would not necessarily do so in each year.[124]

The PPI identified the potential for unintended consequences from proposed value for money policy. For example, requiring schemes to disclose more detail of their asset allocation, with consequences if they fall below a certain level, could lead to less innovation and more herding in investment behaviour.[125]

The ABI said the VFM framework would "act as a key tool for delivering consolidation and shining a light on poor performance." However, there was a risk of the focus on value (and consolidation) unintentionally conflicting with the government's policy of increasing investment into UK assets. If recent underperformance of UK equities to continue, it would reflect poorly in the value metrics of those invested in them, which could have significant consequences for those businesses.[126]

4.5 Defined contribution scheme consolidation

Successive reports have called for consolidation in the pensions market to reduce fragmentation and to gain the advantages of scale. The PLSA says larger schemes could lead to better outcomes:

> Larger pension schemes can facilitate better outcomes for pension savers. Larger schemes generally benefit from economies of scale, stronger governance, the ability to negotiate more favourable costs and charges, and the resources to provide a full suite of member services. In particular, consolidated pension funds can invest in more asset classes requiring high governance costs such as unlisted equity and infrastructure.[127]

In 2021, the Productive Finance Working Group argued that the long tail of small DC schemes was a key reason why a continued focus on cost had been necessary and why investment by DC schemes in longer-term assets was relatively low.[128]

One of the aims in the Pensions Regulator's current strategy is to have a landscape of fewer larger schemes that offer the ability to invest across a range of assets in their members' interest and have the scale to offer

---

124 APPT, Response to Pensions Investment Review (PDF), September 2024

125 Jackie Wells, Pension scheme assets – how they are invested and how and why they will change over time (PDF), September 2024, p 28

126 ABI, ABI response to Pensions Investment Review, September 2021

127 PLSA, Pensions Review – PLSA response to call for evidence, September 2024

128 Productive Finance Working Group, A Roadmap for Increasing Productive Finance Investment (PDF), September 2021

administrative efficiency and good governance. It welcomes the ongoing shift towards fewer, larger, well-run schemes. [129]

The ABI points out that there is a relatively high degree of concentration at provider level – with 79% of assets held by some multi-employer providers managed by just seven providers (some of which will offer both GPPs and master trusts).[130]

Master trusts

An important factor that has contributed to this trend for consolidation is the master trust authorisation framework. master trusts (schemes set up to be used by multiple unconnected employers) entered the workplace pension market to meet the increased need for pension provision under auto-enrolment. Since the introduction of an authorisation framework in 2018, master trusts have become "the vehicle of choice" for auto-enrolment for around 1.3 million employers. By 2023, 90% of members (and 95% of active members) of trust-based DC schemes were in master trusts.

The requirements of authorisation framework had led to consolidation in the market with the withdrawal over 50 schemes. There is now around 35 master trusts, with the five largest (by assets under management) accounting for majority (82%) of members.

The government expects the trust-based market to continue to grow - from around £140 billion in 2023 to about £420 billion in 2030, in real terms - and to continue to consolidate - it anticipates a future in which a smaller number of very large master trusts are in operation, alongside several smaller ones.[131] DWP expects the projected scale of master trusts to enable them to i) access "a broader range of investment opportunities, including those that contribute to UK growth;" and ii) be able deliver better value for money to as they can "benefit from cost saving opportunities that come with economies of scale and deliver new and innovative services to members."[132]

According to the PLSA, the DC sector is consolidating rapidly and is likely to continue to do so:

> The latter are expected to grow from AUM of around £130 billion in 2023 to about £420 billion by 2030. Three of the largest master trusts already manage at least £25 billion in assets. Some GPPs also operate at this scale. At the opposite extreme the number of DC schemes with more than 12 members has declined 67% since 2012; only schemes with over 5000 members have increased in number over that period. Based on PLSA member feedback, as AUM reach c.£20 billion schemes can start to co-invest in private markets;

[129] TPR, Corporate Plan 2024 to 2027, 3 May 2024

[130] ABI, ABI response to pensions investment review, September 2024

[131] DWP, Evolving the regulatory approach to master trusts, November 2023, para 1

[132] As above, para 9; See also PPI, Pension scheme assets – a deep dive into alternatives, September 2024, p7

> above this, schemes can invest directly and may increasingly use in-house investment. Above c£100 billion benefits of scale increase more slowly.[133]

The ABI said that there had already been considerable consolidation at provider level. The UK's DC sector had already achieved a higher proportion of provider concentration than the Australian model it is often compared to, with 79% of assets held by multi-employer providers, managed by just seven providers.[134]

Small deferred pension pots

A measure with potential to contribute to further consolidation would be one to address the proliferation of small pots building up under auto-enrolment. The PPI found that without policy intervention, the number of small pots could increase from 13 million in 2023 to over 27 million by 2035, driven by frequent job changes and potentially lowering the automatic enrolment age to 18.[135] In July 2023, the previous government consulted on a mechanism to reduce the proliferation of small, deferred pots member pots. Its proposal was for a default consolidator model, which would reduce the number of deferred pots under £1,000 by transferring small inactive pots into a consolidator scheme chosen by or allocated to the member. This model would result in DC pots merging into larger more manageable ones, potentially enhancing administrative efficiency and reducing costs. [136] Potential downsides to the policy include members being defaulted into a consolidator scheme with higher chargers or poorer investment performance than their original scheme. There is also a risk that the consolidation process could be complex and costly, potentially offsetting some of the intended financial benefits.[137]

Current trends

In its September 2024 call for evidence for pension investment review, the current government asks about the potential advantages and risks for UK pension savers and economic growth from a more consolidated future DC market. It also asks about the barriers to commercial or regulation-driven consolidation in the DC market, including competitive and legal factors.[138] The PLSA notes that the DC sector is already consolidating rapidly and expects this to continue:

> Most DC savers and assets are served by around a dozen insurers offering Group Personal Pensions, and 36 authorised master trusts. The latter are expected to grow from AUM of around £130 billion in 2023 to about £420 billion by 2030.[139]

133 PLSA, Pensions Review – PLSA response to call for evidence, September 2024
134 ABI, ABI response to pensions investment review, September 2024
135 PPI, How could a Lifetime Provider Model impact members, employers and industry?, February 2024
136 DWP, Ending the proliferation of deferred small pension pots, 11 July 2023
137 PPI, The DC Future Book 2024, p56-7
138 DWP, Pensions Investment Review: Call for Evidence, 4 September 2024
139 PLSA, Pensions Review – PLSA response to call for evidence, September 2024

At the opposite extreme the number of DC schemes with more than 12 members has declined 67% since 2012; only schemes with over 5,000 members have increased in number over that period. Three of the largest master trusts already managed at least £25 billion in assets and some GPPs also operated at this scale. There was also potential for the benefits of consolidation could be delivered in different ways, including through LTAFs, or by Government-initiated entities such as the British Business Bank.[140]

The PLSA saw consolidation as a positive ambition for Government and the sector where it was in the interests of members and represented value for money. Consolidation could lead to better outcomes for savers but was "not a silver bullet for driving investment into UK productive finance and should form part of a much broader strategy", including fiscal and regulatory measures.[141] The risks associated with consolidation included lack of competition, herding of investment choice and potential systemic risks.[142]

140 PLSA, Pensions Review – PLSA response to call for evidence, September 2024

141 PLSA press release, Pension Fund Consolidation brings benefits, but UK growth needs much broader strategy, 26 September 2024

142 As above

The House of Commons Library is a research and information service based in the UK Parliament. Our impartial analysis, statistical research and resources help MPs and their staff scrutinise legislation, develop policy, and support constituents.

Our published material is available to everyone on commonslibrary.parliament.uk.

Get our latest research delivered straight to your inbox. Subscribe at commonslibrary.parliament.uk/subscribe or scan the code below: