Pensions Investment Review: Call for Evidence

Insight Investment response

September 2024

BNY MELLON | INVESTMENT MANAGEMENT

Executive summary

Insight Investment is one of the largest investment managers in the UK, managing £663bn in assets[1], primarily for UK pension funds, as well as insurers, sovereign wealth funds and financial institutions. In this response to the government's Pensions Investment Review: Call for Evidence[2], we focus only on UK defined contribution (DC) pension schemes.

UK DC schemes have millions of members and manage many tens of billions of pounds[3], all with an aim of supporting individuals' future retirement income. Their relevance and influence is set to grow significantly as membership grows and the value of assets increases.

However, as the Call for Evidence implicitly acknowledges, the regime for UK DC schemes is ripe for reform. We believe significant improvements could be made to help ensure individuals ultimately receive a predictable and attractive retirement income that reflects their preferences.

In summary, our response details the following interrelated policy views.

- **DC schemes need to shift from being a savings pot to a focus on retirement income:** Historically, the focus of a DC scheme has been to maximise the savings of members in order to maximise the annuity they might purchase. Pension freedoms have introduced new options, and given their relative immaturity, the focus of DC schemes remains on accumulating assets. The government set out a commitment in the King's Speech in July 2024 to require "pension schemes to offer retirement products so people have a pension and not just a savings pot when they stop work"[4]. DC schemes should be encouraged, if not required, to develop and offer solutions that offer a predictable retirement income for individuals.
- **The DC pensions regime must adapt to operate on a more effective "to-and-through retirement" basis:** The ideal would be for a DC scheme to set investment strategy at the start of a member's journey, and for this strategy to reflect the full journey through retirement to the end of the member's life. Such a strategy could more effectively focus on delivering retirement income. We believe adjustments in the regulatory framework, such as allowing for capital distributions from UK funds, could enable innovation in this area.
- **The mindset must shift from a focus on costs to outcomes:** Costs for DC arrangements inevitably shape investment strategy, with competition driven largely by price. A DC arrangement that adopts a more 'expensive' strategy may struggle to compete. This in turn influences and potentially limits investment in actively managed and private markets – which could undermine member outcomes over the long term.
- **Financial literacy is key:** Today, DC schemes typically focus on helping individuals to accumulate assets up to retirement. At that point, the emphasis shifts, with individuals called upon to make significant decisions – with varying levels of advice – as to how to proceed. Our policy views outlined above address the emphasis of DC schemes on accumulating assets, but regardless of future policy evolution, the need for education and greater financial literacy among DC scheme members is critical.

It is crucial that the Pensions Review is conducted alongside a review of UK private sector defined benefit (DB) pension schemes. Such schemes are in good health overall, with around £1.5 trillion of assets and a surplus estimated at around £225 billion. These surplus assets could be used for a wide range of positive benefits, including supporting or supplementing corporate sponsors' DC schemes, and could be a potential source of investment in UK productive assets. However, for this potential to be realised, policy changes are needed to encourage and enable DB schemes to run on for the long term. More details are in Insight's response to the DWP consultation on DB schemes, available here.

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[1] As at 30 June 2024. Assets under management (AUM) are represented by the value of cash securities and other economic exposure managed for clients. Figures shown in GBP. Reflects the AUM of Insight, the corporate brand for certain companies operated by Insight Investment Management Limited (IIML). Insight includes, among others, Insight Investment Management (Global) Limited (IIMG), Insight Investment International Limited (IIIL), Insight Investment Management (Europe) Limited (IIMEL) and Insight North America LLC (INA), each of which provides asset management services.
[2] Pensions Investment Review: Call for Evidence, 4 September 2024; HM Treasury, Department for Work and Pensions, and Ministry of Housing, Communities and Local Government.
[3] Occupational defined contribution landscape in the UK 2023, May 2024, The Pensions Regulator.
[4] Source: King's Speech 2024: background briefing notes, 17 July 2024, Prime Minister's Office.

PENSIONS INVESTMENT REVIEW – INSIGHT INVESTMENT RESPONSE

Insight is delighted to provide this response to the call for evidence. We are looking forward to this setting the stage for decades of financial security for UK pension scheme members.

Insight Investment

September 2024

Questions and answers

Question 1: In what capacity are you responding to this consultation?

A business

Question 2: If you wish to, please enter details of the business or body you represent.

Insight Investment

Scale and consolidation

Question 3: What are the potential advantages, and any risks, for UK pension savers and UK economic growth from a more consolidated future DC market consisting of a higher concentration of savers and assets in schemes or providers with scale?

Scale, in terms of more assets under management and more members, could provide some clear advantages for DC schemes and for the overall DC regime. Consolidation would help achieve such scale.

As a DC arrangement grows, it could access more opportunities and in new ways. For example:

1. **Ability to access private markets:** Scale can allow DC arrangements to shift from a life platform model to a custody model. This shift would enable greater investment freedom and choice, particularly as those freedoms relate to private markets (including UK productive assets). Private markets can offer access to a wider range of opportunities, offering different underlying sources of returns and income, and with higher potential and/or expected returns than those in public markets.
2. **Ability to co-invest in private markets:** A larger DC arrangement could access private markets through co-investment rather than through a pooled fund. This allows investment in targeted deals rather than in a wider portfolio, enabling exposure to opportunities that offer specific characteristics. Co-investing can also be less expensive than a pooled fund. Additional resources and expertise would be required to assess specific private-market deals.
3. **Ability to manage assets in-house:** The largest DC providers could build in-house expertise to manage private-market programmes, rather than rely on third-party investment managers. This can ultimately lower overall costs and potentially enable a scheme to build a tailored portfolio specific to their needs.

More broadly, we believe scale can help achieve a broader shift in approach.

- **Ability to shift from being a savings pot to a focus on retirement income:** Historically, DC arrangements have focused on maximising members' savings to maximise the annuity they might purchase. Pension freedoms have introduced new options, and given their relative immaturity, the focus of DC schemes remains on accumulating assets. The government set out a commitment in the King's Speech in July 2024 to require "pension schemes to offer retirement products so people have a pension and not just a savings pot when they stop work"[5]. At scale, larger DC arrangements should be able to develop solutions that offer a predictable retirement income for their members. We note there is a commercial incentive for master trusts to develop retirement propositions to retain assets under management.
- **Ability to focus on the true long-term investment horizon:** A larger DC arrangement – in terms of assets and members – would have greater scope to set investment strategy that reflects the full journey through employment and retirement to the end of member's lives. In so doing, they could more effectively focus on delivering retirement income.

These advantages would be positive for pension savers and for the likelihood of investment into UK productive finance. It is worth acknowledging that scale will not, on its own, deliver better outcomes for members or the UK economy;

[5] Source: King's Speech 2024: background briefing notes, 17 July 2024, Prime Minister's Office.

expertise, education and good governance will also be required. Consolidation without considering these factors could impair the desired outcomes.

Question 4: What are the likely impacts of a higher concentration of savers and assets in schemes or providers with scale?

Consolidation might impair choice for savers and has, at extremes, the potential to create an undiversified set of investment risks. Concentration risks, and a reduction in competition, could also occur.

Question 5: What should the role of Single Employer Trusts be in a more consolidated future DC market?

As outlined in our response to Question 1 above, we believe the key question for DC schemes is the extent to which they focus on and offer a predictable retirement income for their members; and the ability to develop an investment strategy that reflects the full journey through employment, retirement and to the end of members' lives, could be the key to achieving this. The key consideration for Single Employer Trusts is whether they are at a scale and have the requisite level of expertise to deliver the most value to members.

Question 6: What should the relative role of master trusts and GPPs be in the future pensions landscape? How do the roles and responsibilities of trustees and IGCs compare? Which players in a market with more scale are more likely to adopt new investment strategies that include exposure to UK productive assets? Are master trusts (with a fiduciary duty to their members) or GPPs more likely to pursue diversified portfolios and deliver both higher investment in UK productive finance assets and better saver outcomes?

We believe that the structure of UK DC arrangements is less important to member outcomes and the likelihood of investment into UK productive finance than scale, expertise, and commercial considerations. For example, scale can allow DC arrangements to shift from a life platform model to a custody model. This shift would enable greater investment freedom and choice, particularly as those freedoms relate to private markets (including UK productive assets).

Question 7: What are the barriers to commercial or regulation-driven consolidation in the DC market, including competitive and legal factors?

While it is worth recognising the consolidation that has already taken place, particularly for trust-based schemes, there is more to be done to extract the value of this consolidation. For example, encouraging 'through retirement' investment pathways for Master Trusts will facilitate innovative investment strategies and a greater incentive to invest in longer term assets.

Question 8: To what extent has LGPS asset pooling been successful, including specific models of pooling, with respect to delivering improved long-term risk-adjusted returns and capacity to invest in a wider range of asset classes?

No comment.

Costs vs Value

Question 9: What are the respective roles and relative influence of employers, advisers, trustees/IGCs and pension providers in setting costs in the workplace DC market, and the impact of intense price competition on asset allocation?

Costs for DC schemes inevitably shape investment strategy, with competition driven largely by price. A DC arrangement that adopts a more 'expensive' strategy may struggle to compete. This in turn influences and potentially limits investment in actively managed and private markets – which could be expected to undermine member outcomes over the long term.

We also believe that financial literacy is key. Today, DC arrangements typically focus on helping individuals to accumulate assets up to retirement. At that point, the emphasis shifts, with individuals called upon to make significant decisions – with varying levels of advice – as to how to proceed. Regardless of future policy evolution, the need for education and greater financial literacy among DC scheme members is crucial, and all industry stakeholders can play a part in supporting such literacy.

Question 10: Is there a case for Government interventions, aimed at employers or other participants in the market, designed to encourage pension schemes to increase their investment budgets in order to seek higher investment returns from a wider range of asset classes?

UK retirees are seeking sources of predictable retirement income. Maturing bond portfolios could offer predictable income with flexibility, ease of use and higher yields than annuities, and provide scope for retirees' other investments to deliver growth – but UK regulations currently prevent such an approach, due to limitations on distributions from capital. The inability of UK funds to distribute capital puts UK retirees at a significant disadvantage compared to retirees in other jurisdictions, and also hinders a considerable source of capital for UK companies. Allowing capital distributions from UK funds would unlock this opportunity.

The FCA could further support retirement outcomes for millions of UK savers by clarifying UK fund rules, either by authorising capital-distributing funds to set a precedent or through an explicit amendment to current rules. Alternatively, the FCA could grant waivers to firms that request the ability to distribute capital in funds targeting the retail retirement decumulation market.

More broadly, we believe that the most effective way to encourage DC arrangements to consider the widest range of asset classes is to focus on scale, resource, expertise and importantly transparency. There is a virtuous circle here: scale and expertise enable investment freedoms; investment freedoms should lead to better investment outcomes and transparency can facilitate choice. Together these factors will be more effective than direct government intervention into investment strategy.

A key consideration by the government, which could have significant influence on the future of DC arrangements, is how to enable and encourage UK private sector defined benefit (DB) schemes to run on for the long term. They are in good health overall, with around £1.5 trillion of assets and a surplus estimated at around £225 billion. These surplus assets could be used for a wide range of positive benefits, including supporting or supplementing corporate sponsors' DC schemes. This could help DC schemes achieve scale and the flexibility to adjust their investment approach, as outlined in our response to Question 3. More details are in Insight's response to the DWP consultation on DB schemes, available here.

Investing in the UK

Question 11: What is the potential for a more consolidated LGPS and workplace DC market, combined with an increased focus on net investment returns (rather than costs), 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?

As outlined in our response to Question 3, we believe the key question for DC arrangements is the extent to which they focus on and offer a predictable retirement income for their members; and the ability to develop investment strategy that reflects the full journey through employment, retirement and to the end of members' lives could be the key to achieving this.

Scale, in terms of assets under management and members, would enable DC schemes to follow such an approach. This could be expected to lead to increased investment in these areas overall, and this could be expected to include greater net investment in UK assets.

We believe it is key to note that private sector UK DB schemes could play a significant role today in such asset classes. As we note in our response to Question 10, they are in good health overall with a sizeable surplus. These surplus assets could be used for a wide range of positive benefits, and potentially be a source of investment in productive projects – which could reinvigorate domestic markets, and to fund green projects to speed up decarbonisation and improve energy security. This could all occur while DB schemes continue to hold gilts and corporate bonds to ensure the security of members' retirement income. More details are in Insight's response to the DWP consultation on DB schemes, available here.

Question 12: What are the main factors behind changing patterns of UK pension fund investment in UK asset classes (including UK-listed equities), such as past and predicted asset price performance and cost factors?

No comment.

Question 13: Is there a case for establishing additional incentives or requirements aimed at raising the portfolio allocations of DC and LGPS funds to UK assets or particular UK asset classes, taking into account the priorities of the review to improve saver outcomes and boost UK growth? In addition, for the LGPS, there are options to support and incentivise investment in local communities contributing to local and regional growth. What are the options for those incentives and requirements and what are their relative merits and predicted effectiveness?

As outlined in our response to Question 3, we believe the key question for DC schemes is the extent to which they focus on and offer a predictable retirement income for their members; and the ability to develop investment strategy that reflects the full journey through employment, retirement and to the end of members' lives could be the key to achieving this.

We believe a new requirement for DC schemes to provide detail on how their investment strategy optimises retirement outcomes for their members, with a focus on ensuring a predictable retirement income through to the end of members' lives, could support this fundamental shift in approach.

There are areas where incentives to invest in UK assets could be made, including:

- the removal of stamp duty on UK equities, and
- an acknowledgement that greater investment into UK assets by DC arrangements will require greater supply (e.g., of infrastructure projects).

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