Institute and Faculty of Actuaries

16 January 2025

IFoA response to Pensions Investment Review: Unlocking the UK pensions market for growth

The Institute and Faculty of Actuaries (IFoA) is a royal chartered, not-for-profit, professional body. We represent and regulate over 34,000 actuaries worldwide, and oversee their education at all stages of qualification and development throughout their careers. Actuaries are big-picture thinkers who use mathematical and risk analysis, behavioural insight and business acumen to draw insight from complexity. Our rigorous approach and expertise help the organisations, communities and governments we work with to make better-informed decisions. In an increasingly uncertain world, it allows them to act in a way that makes sense of the present and plans for the future.

Key points

- If the Government is keen to significantly accelerate the existing consolidation trend in the UK DC pensions market, applying a minimum asset size requirement is a simple - but blunt - solution. But it comes with significant potential risks and unintended consequences.
- We understand the Government's desire to increase allocations of pension scheme asset to UK investments. However, we believe that investment decisions (particularly in relation to DC default investment strategies) should, as currently, be focussed on achieving the best outcome for members. The investment aspects of the VfM framework should focus on longer-term net of all fees/costs returns.
- While we agree that consolidation can achieve better outcomes for members, by accessing economies of scale and creating opportunities for better governance and more sophisticated investment strategies, there is no clear point where scale in of itself is likely to deliver better outcomes for members. Size is therefore a somewhat artificial measure for quality, when compared to measuring and enforcing good governance standards and investment sophistication.
- The risks and potential unintended consequences of introducing a minimum asset size include a lack of real choice for members, stifling of innovation and systemic risk and herding behaviours (especially if these providers are also subject to league table style backward looking benchmark comparisons as part of the Value for Member (VfM) framework.) Innovative propositions could also be closed even when functioning well if they fail over time to reach the scale intended.

Beijing	Room 512 · 5/F Block A · Landgentbldg Center · No. 20 East Middle 3rd Ring Road · Chaoyang District Beijing · 100022 · People's Republic of China	**Tel:** + 86 10 5878 3008
Edinburgh	Space · 1 Lochrin Square · 92-94 Fountainbridge · Edinburgh ·EH3 9QA	**Tel:** +44 (0) 7632 2100
London (registered office)	1-3 Staple Inn Hall · High Holborn · London · WC1V 7QJ	**Tel**: +44 (0) 7632 2100
Malaysia	Arcc Spaces · Level 30 · Vancouver suite · The Gardens North Tower · Lingkaran Syed Putra · 59200 Kuala Lumpur	**Tel:** +60 12 591 3032
Oxford	Belsyre Court · 1st Floor · 57 Woodstock Road · Oxford · OX2 6HJ	**Tel:** +44 (0) 7632 2100
Singapore	Pacific Tech Centre · 1 Jln Kilang Timor · #06-01 · Singapore 159303	**Tel:** +65 8778 1784

actuaries.org.uk

Introduction

The IFoA is pleased to respond to the joint HMT / DWP consultation on “Pensions Investment Review: Unlocking the UK pensions market for growth”.

Many of our Profession’s members will be responding to the consultation on behalf of providers, consultancies and other industry bodies. We have focussed our comments primarily on the impact the proposal would have on members of UK Defined Contribution (“DC”) schemes, both contract and trust based.

We have therefore not answered the individual questions directly, but instead set out below our views on each of the main sections of the consultation.

Achieving scale in the Defined Contribution market

- If the Government is keen to significantly accelerate the existing consolidation trend in the UK DC pensions market, applying a minimum asset size requirement is a simple - but blunt - solution. But it comes with potential risks and unintended consequences.

- We understand the Government’s desire to increase allocations of pension scheme asset to UK investments. However, we believe that investment decisions (particularly in relation to DC default investment strategies) should, as currently, be focussed on achieving the best outcome for members. The investment aspects of the VfM framework should focus on longer-term net of all fees/costs returns.

- While we agree that consolidation can achieve better outcomes for members, by accessing economies of scale and creating opportunities for better governance and more sophisticated investment strategies, there is no clear point where scale in of itself is likely to deliver better outcomes for members. Size is therefore a somewhat artificial measure for quality, when compared to measuring and enforcing good governance standards and investment sophistication.

- The risks and potential unintended consequences of introducing a minimum asset size include a lack of real choice for members, stifling of innovation and systemic risk and herding behaviours (especially if these providers are also subject to league table style backward looking benchmark comparisons as part of the Value for Member (VfM) framework.) Innovative propositions could also be closed even when functioning well if they fail over time to reach the scale intended.

- If a minimum AUM size is to be introduced, it is not clear that this should be at the default fund level. Many default funds will invest in underlying pooled funds, which is where size and scale will matter. It would also not be practical to mandate a size for any underlying funds without restricting significantly the opportunities to invest in more innovative or specialised investment types. So any minimum size requirements, if introduced, may need to be at provider level.

- We also note that it will be some time before decumulation funds will be able to reach the sort of asset sizes being considered. Appropriate design and investment of decumulation funds will become increasingly important to member outcomes. Other elements of the phase 2 pensions review, such as extending coverage to the self-employed, also need to be included in the thinking process now.

- The proposed approach is likely to benefit the largest existing DC providers – raising their number of members/policyholders, assets under management and introducing material barriers to any new entrants to the market.

- We believe that a focus on establishing a clear VfM framework for all DC arrangements, with a requirement for any scheme that does not meet the VfM standards to improve or consolidate, would be a more balanced approach that would still drive consolidation but avoid introducing barriers to entry and continuing to reward innovations that improve overall VfM.

- If a requirement was introduced for regular review of default investment options, which included the requirement to take appropriately independent and regulated advice, this could also help drive consolidation – such reviews could identify that, even where VfM targets are being met, more optimal solutions could be available.

- Consolidation alone is not expected to achieve a greater home bias, if the focus continues to be what is in the member's best interests. It is also unlikely to directly result in greater investment in "productive" assets. If the Government wants to achieve greater levels of UK investment then the two routes possible would be to mandate a minimum percentage in specific asset types (which we note could be a barrier to achieving optimal member outcomes) or to provide incentives for investing in particular asset types. Such incentives would produce a strong underlying investment rationale to invest in these assets and would therefore not be counter to ensuring appropriate member outcomes.

- Clearly, developing the supply of attractive UK productive assets and opportunities for investment would also result in a more natural increase in such asset holdings by DC schemes.

- The suggestion of only allowing a single price for each default arrangement would be another relatively blunt approach. This would potentially benefit employees of smaller organisations that have less commercial leverage in negotiating with DC providers compared to larger organisations. However, cost would remain a transparent point of comparison when selecting a provider so would still remain a key (albeit flawed) differentiator. Again, a suitable VfM framework would appear to be a more nuanced and balanced approach than a single price proposal.

Contractual override without consent for contract-based arrangements

- We support the principle of allowing GPP transfers on a non-consent basis, provided appropriate safeguards, appropriate advice requirements and opt-out provisions are introduced.

- It would be important that there is a clear process for such transfers to take place, This could build on the existing provisions for transfers between Single Employer Trusts and Master Trusts.

- Examples of suitable safeguards would include the need for any receiving arrangement to meet the VfM requirements, for the IGG/GAA of the transferring arrangement to take independent professional advice and for clear and timely member communications (including a process for objections to be raised/considered and for members to be able to opt to transfer elsewhere within specified timescales and at their own cost). There are parallels with the requirements of transferring books of insurance business that would be worth reflecting on.

- In order to drive the widest possible range of consolidation addressing legacy DC arrangements should also be considered. Unless such legacy funds have complex terms (such as underpins or guarantees) it is likely to be in members' interests to be able to transfer members to current arrangements, especially where such legacy arrangements are no longer optimal, receiving attention or innovation from providers or are potentially more expensive than other options. Encouraging transfers of such legacy funds would also support consolidation.

- Careful consideration would be needed to ensure risks to members on transfer – such as out of market risk while funds are transferred – and costs associated with the transfer; operational advice, but also transaction costs are appropriately addressed in any guidance and process.

Costs versus Value: The role of employers and advisers

- Large Employers who are actively engaged in ensuring appropriate provisions for their employees, are likely to achieve better outcomes for their members, provided they are suitably advised, so that cost is not the sole focus.

- Low cost does not necessarily result in good value. We would expect any of our members involved in supporting an employer to select or review their DC arrangement to look a wide range of areas beyond just purely the annual management charge. This would include advice on VfM.

- There may be advantages to requiring such advice to employers to be regulated, to ensure that appropriate advice is being received.

- Most smaller employers are unlikely to take advice or have the ability and expertise themselves to assess quality of pension provision in detail, and it would likely be counterproductive to impose such requirements on them. However, in our view there would be merit in considering specific employer responsibilities with regard to the quality of pension provision for employers over a minimum size.

We would be happy to meet to discuss any of the points we have raised or to expand on any specific areas if helpful.