Pensions Policy Institute
PPI

Launch Event Write Up

Overview

On Monday 9 September 2024 the PPI held an event to launch the first report of its Asset Strands project – **Pension scheme assets – how they are invested and how and why they change over time.** The event was kindly hosted by the Association of British Insurers (ABI) and was chaired by **Daniela Silcock, Head of Policy Research (PPI).** It was attended by just over 50 people representing a cross section of the industry.

Host welcome

Rob Yuille, Assistant Director, Head of Long-Term Savings Policy (ABI), welcomed attendees and commented on the very timely nature of the publication. The report provides impartial data and analysis that will be useful for informing the current Pension Investment Review.

Keynote speech

Emma Reynolds MP, Parliamentary Secretary at HM Treasury and the Department for Work and Pensions, provided an overview of the government's current approach and planned activities relating to pensions investment. As the first minister to sit jointly across the Treasury and DWP, the government intends to break down silos and create a cross-policy approach to the challenges faced in pensions, with two main objectives:

- Increasing pension scheme investment in UK productive assets; and
- Improving outcomes for future pensioners.

It is anticipated that reform to enable schemes to invest more in UK productive finance will stimulate growth and improve outcomes for members. In order to produce effective policy solutions, it is vital that we know the scale and nature of the challenge. This report provides a solid foundation of evidence, bringing together many data sources on pension fund asset allocation for the first time.

Time has been set aside in the new government's first parliamentary session for a new Pensions Bill, which will seek to address:

- Consolidation of eligible small pots
- VFM framework – including the test DC schemes must meet – with the aim of further encouraging consolidation

- Requirement for schemes to offer retirement solutions to support member outcomes and investment

The current Pension Review will feed into the Bill. The first phase of the Review focuses on investment, particularly increasing investment in UK productive finance. The second phase will focus on adequacy, contribution levels and extension of automatic enrolment.

Research Findings

Jackie Wells, Research Associate (PPI), presented an overview of the report's key findings. While there are some aspects of pension fund investment we know a lot about, there are others where we know relatively little. High-level asset allocation data is most plentiful for trust-based schemes, including both DB and DC, while data on contract-based DC schemes is sparser. For more granular data, including information on productive finance and UK assets, less is known overall. Data sources are often incomplete and inconsistent, which makes the task of estimating allocations across the landscape particularly challenging. Further exacerbating this challenge is the complexity of language and definitions used in relation to asset allocation, with terms with slightly different meanings often used interchangeably, and a lack of clarity over the definition of others. In order to improve the accuracy of data on asset allocation, it is critical that definitions of asset classes are standardised.

There are around £3 trillion of UK pension assets and significant variation in asset allocation by scheme type, with DC and public sector DB schemes more heavily invested in listed equities, while private sector DB schemes and buy-out and annuity providers allocate more heavily to bonds. Allocations to alternative assets represent a smaller proportion of portfolios across scheme types, with particularly low allocation among DC schemes and buy-out and annuity providers. UK pension funds hold approximately £541 billion of UK assets, spread across listed equities, alternatives and corporate bonds. DB schemes are the largest UK investor by total amount (private sector) and proportion of portfolio invested (public sector).

The UK pension sector is in a period of transition:

- DC is gaining scale as workplace pension participation increases and schemes consolidate.
- For DB schemes in the private sector, winding up and buy-out processes are likely to continue.
- There is pressure on LGPS to consolidate further.
- CDC emerging in the market, but take up likely to be limited, at least for now.

There are multiple drivers of change in asset allocation, including:

- Member outcomes and maturity;
- Performance, cost and accessibility of assets;
- Size and profile of scheme;
- Government and regulatory policy; and
- Climate change/ESG.

Members should benefit from trends in asset allocation, with closed DB benefits secured, open DB members benefiting from diversification and DC members benefiting from better designed and diversified defaults. Investment governance and value for money will become even more important. It is vital that member outcomes remain the core driver of asset allocation decisions.

Sponsor response

Mike Eakins, Chief Investment Officer and Group Executive Committee Member (Phoenix Group plc), provided the sponsor's response to the research. He highlighted that pension scheme asset allocation has the potential to have a significant impact, both on member outcomes and the economy more broadly, but there is a lack of clear data on asset allocation trends at present. Better data, as set out in the report, will enable industry and policymakers to improve outcomes for members.

The remainder of the event was held under the Chatham House Rule.

Panel discussion and Q&A

The following points were raised during the panel discussion and Q&A session:

- What is the rationale for increasing pension fund investment in UK assets? Is it to improve member outcomes or primarily driven by government policy to stimulate the UK economy? There is a potential for tension to arise between trustees' fiduciary duty to act in members' best interests and government targets if investing in UK productive finance does not deliver improved member outcomes. There is a question around whether member outcomes should be considered purely in terms of increased returns on pension investments, or whether increased investment in UK productive finance is good for society and therefore may be good for members in that sense. Members are the most important stakeholders so focus needs to be on investing over the long term to deliver them optimal outcomes for retirement, but it should be possible over such long investment horizons to invest in a way that also benefits shareholders and the wider societal good.
- There are economic benefits of diversification which schemes (and therefore members) will potentially miss out on if they invest too heavily in the UK, especially if they have to meet rigid allocation targets. Markets will ebb and flow so having X% targets for specific regions could lead to poorer outcomes as schemes would be unable to take advantage of the cyclical nature of markets. It is important that investment decisionmakers can be agile in allocation to respond to market shifts in order to deliver optimal outcomes for members.

- As default funds shift to include LTAFs and private markets more broadly, it will be interesting to see how this interacts with the debate around absolute cost vs. overall value.
- Schemes that are identified as underperforming by the VFM framework will face severe consequences, potentially closure of the scheme. UK equities have underperformed over the last 10-20 years. Is there a risk that schemes which make a significant shift into UK assets may underperform and fail VFM tests as a result?

- Is there sufficient supply of suitable UK assets for pension funds to invest in? Considering the starting point of the Mansion House Compact, with schemes committing to allocate 5% to private markets, are there enough UK private market assets for schemes to allocate this proportion of their portfolio purely within the UK market?
- What conditions need to change to make UK investments more attractive to pension schemes? Political stability is needed to make the UK an attractive investment and since 2016 there has been significant turbulence. It is expected that there will now be a period of greater stability and focus on investment. Increasing the supply of UK productive finance assets and making them a more attractive proposition to pension schemes should also increase demand from international schemes; is there a reason that the government is seeking greater investment from UK schemes specifically or should increased investment from overseas also be encouraged? However, there are potential herding risks if UK private markets suddenly become more attractive, and as schemes with substantial scale are likely to be more attractive investors as they can potentially have a much greater impact for the same level of investment as smaller schemes, there's a risk that larger, more mature international schemes could mobilise more quickly to benefit from increasingly attractive UK productive finance supplies, making it more difficult for UK schemes to allocate.

- Will data on asset allocation improve in the near future? Within the next year, there should be more data available, including PPI data from surveys, which have been aligned to DWP/HMT definitions of asset classes in order to increase response rates and consistency of data. There will soon be a year's worth of data available under DWP's increased reporting requirements. LGPS reporting requirements have become much more prescriptive, so data should be available at a more granular level, although aggregation and publication may still be a challenge. While there is consensus that it would be useful to have greater levels of granularity, data is heavily dependent on what schemes are capable and willing to provide. Disclosure is unlikely to improve drastically without a regulatory push.

Related Publications in the Asset Strands Series:

Pension scheme assets - a deep dive into alternatives

Pension scheme assets - a deep dive into infrastructure