

Pensions Investment Review

Call for evidence

A submission by:
The Chartered Institute of Public Finance and Accountancy

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CIPFA, the Chartered Institute of Public Finance and Accountancy, is the professional body for people in public finance. CIPFA shows the way in public finance globally, standing up for sound public financial management and good governance around the world as the leading commentator on managing and accounting for public money.

Further information about CIPFA can be obtained at www.cipfa.org

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1. Background

- 1.1 This is a response on behalf of CIPFA to the following call for Evidence: [Pensions Investment Review: Call for Evidence - GOV.UK \(www.gov.uk\)](https://www.gov.uk/government/consultations/pensions-investment-review-call-for-evidence)
- 1.2 This is part of the Government's wider Pensions Investment review, announced in July: [Chancellor vows 'big bang on growth' to boost investment and savings - GOV.UK \(www.gov.uk\)](https://www.gov.uk/government/news/chancellor-vows-big-bang-on-growth-to-boost-investment-and-savings)
- 1.3 This call for evidence asked a range of questions over three headings: Scale and Consolidation, Cost vs Value and Investing in the UK. The questions involve DC schemes as well as LGPS. Other DB schemes are outside the scope of the review. Questions solely concerning DC schemes are outside the scope of CIPFA's response.

2. Scale and Consolidation

- Q1 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?**

CIPFA's response is concerned with the LGPS, this question lies outwith the scope of our response.

- Q2 What should the role of Single Employer Trusts be in a more consolidated future DC market?**

CIPFA's response is concerned with the LGPS, this question lies outwith the scope of our response.

- Q3 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.**

CIPFA's response is concerned with the LGPS, this question lies outwith the scope of our response.

- Q4 What are the barriers to commercial or regulation-driven consolidation in the DC market, including competitive and legal factors?**

CIPFA's response is concerned with the LGPS, this question lies outwith the scope of our response.

Q5 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?

LGPS Pooling has certainly given Funds access to asset classes that they may have struggled to invest in beforehand, primarily due to lack of resources and expertise. A more diverse asset base is, in general more desirable from a risk management perspective for any Fund. It's more difficult to answer if it has yielded greater returns since the great unknown is what would Funds have done without Pools. Pools have only been existence for 6/7 years and Pension Fund investment horizons are far longer. So perhaps it's too soon to give a definitive answer on risk-weighted returns.

3. Costs vs Value

Q1 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?

CIPFA's response is concerned with the LGPS, this question lies outwith the scope of our response.

Q2 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?

There is little evidence that LGPS Funds do not currently maximise their Investment Budgets within sensible parameters:
A Funds fiduciary responsibility is primarily to its members and ensuring that their future benefits are assured, and that liquidity exists to pay benefits when they fall due. Generally, an LGPS Fund would optimise its "Investment Budget" to ensure that sufficient funds are available to pay current liabilities. So, any increase beyond that would be imprudent and inevitably lead to more leverage and risk, as borrowing may be required to fill short-term cashflow deficits.

4. Investing in the UK

Q1 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?

A focus on net returns rather than costs would be welcome, insofar as decisions have been made that may have lowered costs but have possibly dampened returns and increased risk (a move towards passive and factor-based investments). In fact, as the LGPS is generally one of the lower cost DB Funds in existence anyway, a focus on further lowering costs would yield diminishing returns.

It does not automatically follow that Investing in UK Assets and Asset classes mentioned would guarantee these better returns, although reducing FX exposure would lower risk. As has been mentioned in this response elsewhere, a focus on the barriers that currently exist for funds to invest in these assets (scalability and structure) would be welcome.

Q2 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?

The main drivers of Investment decisions are typically, for a Pension Fund, seeking long-term growth, or a predictable income stream, depending on the Fund's maturity. Being a mature economy, UK equities may not appear as attractive for growth-seeking investors as emerging markets, or other regions which have experienced more economic growth. The period of relative stagnation that has followed the 2008 Financial crisis in the UK and other Western economies, has also not helped.

Q3 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.

A fund like the LGPS, or any DB Fund would generally also have its Funding position as a key driver to its investment mix. The current, historically favourable, funding position of the LGPS would normally obviate a move towards less risky assets (ie. bonds) and away from more volatile and risky assets, such as Private Equity. So, any external incentive or requirement to invest in such assets would appear counterintuitive, if not against the best interests of the Fund Members. As such a system of incentives or penalties for requiring Funds to invest in certain Asset classes should be avoided as it could lead to a regime of perverse incentives. Trying to remove the traditional barriers to investing in UK Assets could be an area of focus though, such as scalability and structure.