Response by TISA to the DWP Call for Evidence: Pensions Investment Review

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About TISA

The Investing and Saving Alliance (TISA) is a unique, rapidly growing membership organisation for UK financial services.

Supporting the financial journey through life

Our ambition is to improve the financial wellbeing of all UK consumers by working collectively with the financial services industry to deliver solutions and champion innovation, for the benefit of people, our industry, and the nation.

We do this by working with our member firms to deliver practical solutions and devise innovative, evidence-based strategic proposals for government, policy makers and regulators that address major consumer issues.

TISA is a **not-for-profit membership organisation** and a trusted partner of key industry stakeholders in helping shape the future of the UK financial services and the environment in which we operate. **We have over 270 member firms** involved in the supply and distribution of **savings, investment products and associated services**, including the UK's major investment managers, retail banks, online platforms, insurance companies, pension providers, distributors, building societies, wealth managers, third party administrators, FinTechs, financial consultants, financial advisers, industry infrastructure providers and stockbrokers.

Our work, your influence

With a focus on three strategic pillars of work to best support the consumer and UK financial services, TISA has become a major industry delivery organisation for consumer focused and digital industry infrastructure initiatives. Our three pillars of work remain at the forefront of everything we do:

- **STRATEGIC**
  Build **Strategic policy initiatives that influence policy makers** regarding the financial wellbeing of UK consumers & thereby enhancing the environment within which the industry operates in the key areas of consumer guidance, retirement planning, later lifetime lending, vulnerable customers, financial education, savings and investments.

- **TECHNICAL**
  Provide **expert technical support to members** on a range of operational and regulatory issues targeted at improving infrastructure and processes, establishing standards of good practice and the interpretation and implementation of new rules and regulations covering ISAs, Consumer Duty, client assets, responsible & sustainable investing, operational resilience, vulnerable customers, governance, conduct & culture, plus a range of other areas.

- **DIGITAL**:
  To transform our industry architecture by building **digital transformation initiatives** that are driving ground-breaking innovation. TISA has become a major industry delivery organisation for consumer focused, digital industry infrastructure initiatives, with projects including **Digital ID** and **Open Savings, Investments & Pensions (OSIP)**. This reflects TISA's commitment to open standards and independent governance.

More here**:** **https://www.tisa.uk.com/about-tisa/**

Executive Summary

TISA welcomes the opportunity to respond to the DWP Call for Evidence - Pensions Investment Review.
The DC pensions landscape continues to go through significant change, as initiatives designed to increase engagement and enhance retirement outcomes come through the pipeline – including Pension Dashboards, Small Pots, Decumulation, the Pension Review and Value for Money (VfM).

These changes compliment the objective to reduce the number of DC schemes operating in the UK market, which will lead to bigger schemes but more importantly, mean that those that continue to operate demonstrate they are offering VfM to their members.

Whilst we understand the desire for pension schemes to increase investment into UK productive finance, scheme trustees, IGCs and managers have duties placed on them to ensure they act in the best interests of their members. This can often result in UK investment government objectives conflicting with scheme governance, with the latter naturally taking priority.

A more contracted UK DC market also means that schemes which continue to operate will come under the spotlight more clearly for poor performance, notably with the introduction of the VfM framework. Investment decisions which may lead to longer-term enhanced outcomes but come with greater risk will not be attractive to schemes, for fear that a deviation from a standard asset mix will lead to a negative divergence from average default returns. This could then lead to a reduced VfM rating which comes with a reputational and commercial impact.

Incentives which may offset some of the potential downside of investing in UK productive finance may help increase investment levels. More generally, incentives geared to incentivising business creation and UK stock market listings could lead to the UK stocks performing more competitively from a global perspective and increase the investment opportunities for pension schemes.

Ultimately, investment decisions have to be reflective of the scheme demographic and as such, any form of compulsion on pension schemes to direct a percentage of funds to UK productive finance would be inappropriate.

We would welcome the opportunity to discuss any aspect of this response with you and look forward to future engagement, as we collectively work to drive up retirement outcomes and financial wellbeing for UK consumers.

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Question responses:

Scale and consolidation

1. 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?

DC schemes that have higher Assets under Management will benefit from economies of scale, which will include the ability to access certain asset classes which may not be available to smaller schemes due to cost restrictions. Generally, research has shown that bigger schemes are better governed and have a wider selection of tools and options to benefit their members. That is not to say that smaller schemes do not offer Value for Money (VfM). Whilst we currently experience organic consolidation which will be increased by the VfM framework, it is important that smaller schemes which clearly demonstrate they offer VfM are allowed to operate in the market. Forcing further consolidation to reduce the DC market to a handful of schemes would create a 'too big to fail' situation where a single failure would be disastrous to scheme members and the wider financial system. A very small number of players in the market would also stifle innovation to an extent, where risk-based approaches which could potentially yield better member outcomes would not be adopted for fear of them failing and the scheme then being very clearly isolated from the rest. Lastly, a highly contracted market in terms of providers could lead to monopolistic issues, where choice is restricted and operating schemes have greater control over market activity which could lead to member outcomes not being maximised.

It is the size of the default which will determine the ability to invest in alternative assets, rather than the size of the scheme in its entirety. This is an important aspect to recognise as schemes of all sizes could be investing in the same assets for their 'off the shelf' default fund.

2. What should the role of Single Employer Trusts be in a more consolidated future DC market?

If a Single Employer Trust can demonstrate it offers VfM, then the role of the scheme should be no different to what its role is today. Many of these schemes have highly paternalistic sponsoring employers with employees represented on the trustee boards. The connection between the employer, employee and scheme allows employers to have an element of control over scheme communications and benefit options. The importance of the role of the employer and their ability to help engage employees should not be undervalued. These schemes provide a highly effective and more personalised service in many instances over and above what a Master Trust or GPP which has hundreds or thousands of employers can offer.

3. 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?

Master trusts and GPPs play crucial roles in helping achieve a thriving DC private workplace pension market. Both these scheme types also have a significant role to play in the forthcoming VfM framework, with these being used as comparators by smaller schemes. With schemes not offering VfM being encouraged to consolidate into larger arrangements, we expect to see both Master Trusts and GPPs continue to grow in size and further consolidation within this sector to take place.

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The role of IGCs and Trustees at a high level are similar, however their structure, responsibilities and liabilities are very different. Whilst trustees have a fiduciary duty to their members, IGCs (and some trustees) have the Consumer Duty to adhere to. Both exist to ensure the underlying members are protected and well represented by their pension scheme and this, of course, extends to performance of the default fund. The member demographic will largely dictate what the default comprises and as such, neither Master Trusts or GPPs are more or less likely to invest in UK productive finance. This can be evidenced through a review of pension schemes which operate in both markets – many of these will use the same default fund for their GPP and Master Trust.

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

An obvious legal constraint to consolidation for contract-based DC schemes is the inability to transfer without member consent. This has been highlighted in the VfM framework consultation with potential legislative changes being explored.

Schemes which are invested in alternative assets such as direct property may influence how easy it is to consolidate into another scheme. These assets are not valued on a daily basis and transferring the beneficial owner or selling the asset can be a lengthy process.

Some Master Trusts do not accept employer schemes which fall under their minimum threshold in terms of size. Ideally, we would like to move away from this two-tier structure and mandate schemes to accept business of all sizes. Indeed, in a more consolidated market with reduced choice, this becomes an increasingly important issue to address.

Where guarantees exist, these may be lost on transfer which may prevent consolidation taking place. For instance, some schemes do not administer a protected retirement age of 55. Despite entitlement rules being clarified in legislation, HMRC have stated it is up to schemes to choose whether they want to administer this or not. As such, those that do not administer it means a potentially valuable benefit would be lost on consolidation to that scheme.

Strong governance is also required to ensure the VfM framework operates as intended and schemes are fulfilling requirements to the full. Schemes which meet the criteria including having assets of under £100 million must carry out a more detailed VfM assessment. Fewer than a quarter of defined contribution schemes are meeting their VfM requirements, with just 16% of small and 18% of micro schemes assessing the extent to which member-borne charges and transaction costs provide good value.

5. 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?

N/A

Costs vs Value

1. 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?

There has been a heavy focus on costs. Employee Benefit Consultants in particular have played a significant role in driving down costs for the employers they represent and use this metric as a key factor in determining which scheme is most appropriate.

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For some employers, Auto Enrolment was seen as an additional expense and as such, chose the cheapest scheme they could find. Recent research has shown that some employers have recouped some of the cost of their pension contributions by reducing take-home pay.[i]

We would expect the focus to shift to a more holistic approach when the VfM framework becomes embedded, however costs will continue to play a prominent role when scheme selections are made. This, along with the charge cap does have the impact of influencing default fund compositions. Whilst performance fees can now operate outside of the cap, schemes which are currently operating defaults comfortably within the cap are reluctant to suddenly increase the cost to employers and members.

2. 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?

Given that trustees and IGCs have their respective duties to meet which includes ensuring the scheme default is meeting its objectives, it would be inappropriate to introduce any form of compulsion on firms to direct funds to certain asset classes irrespective of the scheme demographic. From an equity's perspective, global equity has outperformed UK equity in recent years. Arguably, investing in UK stocks would not have achieved VfM for scheme members and as such, investment decisions by professionals have correctly directed funds to better performing overseas stocks.

In the absence of strongly performing UK stocks, incentives will be needed to drive up the UK economy by expanding both the number of UK investment opportunities and the amount of money being directed to them. From a pension scheme perspective, incentives could include reintroducing the dividend tax credit for UK assets and removing any stamp duty taxes.

In the private Defined Benefit space, we have seen schemes securing their positions and moving to a buy-out or buy-in. The funds used to facilitate these transactions have restricted investment options. Potentially changes in this area could help meet government objectives for UK productive finance.

We do need to be mindful that increasing UK investment is not without its risks and investment decisions have to be reflective of the pension scheme and the members it represents. Investing in private assets brings with it, its own set of potential risks and rewards and needs appropriately skilled investment experts to make decisions in this sector. It is worth remembering that 60% of British start-ups fail in the first year.

Given the VfM framework has not yet been implemented, it would be prudent to assess the effectiveness of this once it has been embedded to establish whether any further considerations are needed from a UK productive finance perspective.

Investing in the UK

1. 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?

It is worth highlighting that LGPS and the workplace DC market do have distinct differences and as such, should be considered on a standalone basis. Notably, LGPS is underwritten by the UK government and if investment performance fails, it is effectively bailed out by the government. If DC investment does not meet its objectives, it is the members which are disadvantaged. Any form of investment compulsion could also lead to reputational damage to the government where member outcomes are damaged.

The VfM framework, once implemented, will lead to a more consolidated DC market. Net investment returns do feature as a published metric, which may lead to an increased focus on UK growth. The Mansion House compact has also seen some pension schemes commit to future UK investment.

2. 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?

Despite the decline of Defined Benefit schemes in the private sector, there remains over 5,000 schemes with £1.4 trillion in assets. As these schemes mature and their funding positions improve, many are moving to buy-out and buy-in which means a change of investment strategy and assets. Given the scale, this significantly impacts on investment patterns at a macro level.

There is a degree of conflict that exists between VfM and UK investment. To achieve a green VfM rating requires firms to compare on a no worse basis to the comparators. If UK investment (either private or listed) performs worse than global stocks, this may lead to a firm achieving an Amber rating. With the current proposed RAG status rating, it is unlikely that a pension scheme will direct investment into this sector. Should UK investment opportunities become an improving picture and it is deemed an appropriate investment for the scheme, we may see greater investment being directed to UK productive finance.

3. 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?

For DC schemes, it is likely some form of incentive is needed to significantly drive-up level of investment in UK productive finance. These could include reintroducing the dividend tax credit for UK assets and removing any stamp duty taxes.

If UK investment opportunities were expanded by incentivising business growth and firms to list and stay listed in the UK, this could help create a thriving UK market which is attractive for pension schemes to invest in. Ultimately, investment decisions must be appropriate for the scheme members.

[i] The research was conducted by Rachel Scarfe of the University of Stirling, Daniel Schaefer of Johannes Kepler University Linz, and Tomasz Sulka of the University of Dusseldorf