ShareAction»

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16 January 2025

Pensions Investment Review - Unlocking the UK pensions market for growth – Consultation on reforms to the Defined Contribution pension market to build scale and put savers first

1. ShareAction is a UK registered charity that works to build a financial system that serves our planet and its people. ShareAction works to define the highest standards for responsible investment, mobilising investors to take action to improve labour standards, tackle climate change and the biodiversity crisis, and address global health issues. We have strong relationships with financial regulators, government departments, investors and asset owners including UK defined contribution pension schemes. ShareAction was previously called Fair Pensions and we have called for fiduciary duty reform and pensions reform generally for over 10 years.

2. We write in response to the Pensions Investment Review consultation on reforms to the Defined Contribution pension market published on 14 November 2024. We are pleased to respond to this consultation and we would be delighted to discuss anything in this submission and the documents to which we refer.

3. We note that you received over 200 responses to the previous Call for Evidence and that this is a further extensive consultation with 42 detailed questions to which you will receive many replies. Our response to this consultation is therefore focussed on the key areas of concern to ShareAction, in particular **Chapter 2 and Chapter 4** and Questions 30 and 32.

<u>Chapter 2 – Achieving scale in the Defined Contribution market</u>

In relation to the government's aim of **driving scale and consolidation of defined contribution workplace schemes**, we would like to make the following observations:

4. In principle, ShareAction supports the government's aim of fewer, bigger, better-run schemes. We are generally in favour of consolidation given the potential for better investment decision-making, higher returns and the greater impact potential of investments, and we welcome the general trend towards consolidation where this is in the interests of members and leads to improved outcomes for members and beneficiaries.

5. We note that according to the DWP's own research, in particular as referenced in its recent report *"Pension fund investment and the UK economy"*[1] the evidence of the benefits of scale is mixed. Paragraph 66 summarises the key benefits of scale within the DC pensions market as being better governance; economies of scale, with greater size helping to reduce average costs

[1] https://assets.publishing.service.gov.uk/media/673f3ca459aab43310b95a8d/pension-fund-investment-uk-economy.pdf

per member; the ability to move investment in-house, potentially reducing investment costs; access to a wider range of assets; being able to invest directly in certain assets, rather than needing to be part of a pooled fund to do so; and improved bargaining power, including the ability to pay lower investment fees. Table 6 of the same report summarises the evidence on the AUM size needed to achieve these scale benefits. The consolidation of DC pension schemes should therefore help the government to achieve some of its objectives, in particular the greater potential ability of larger schemes to diversify investments, to increase investments into private market asset classes, and to boost economic growth.

6. Our concern is that **increased scale does not necessarily result in better outcomes for members**.
   a. The DWP's own research as cited above states at paragraph 70 that *"The evidence linking pension provider scale and gross investment returns is mixed. DWP analysis of CAPA data shows weak correlation between the asset size of Master Trusts / GPPs and five-year gross investment performance. Across the AUM spectrum, there are examples of small, medium and large-sized schemes with both high and low gross returns."* Figure 11 of this report clearly shows the lack of correlation between size of UK DC pension providers and gross returns.[2]
   b. Paragraph 71 of this DWP report also notes that international evidence seems inconclusive on the benefits of scale on gross investment returns, with McKinsey analysis suggesting that smaller pension funds can do just as well as larger ones, and evidence from 49 US pension funds finding almost no correlation between fund size and achieved gross investment returns.[3]
   c. We would therefore like to see further consideration given as to how consolidation can be managed in a way which ensures better outcomes for members.

7. One potential way to help reduce risks and ensure that consolidation focuses on delivering tangible benefits to pension savers would be to ensure that the resulting larger consolidated funds are run on a not-for profit basis, focused on the interests of their members. In a for-profit model there is a clear conflict of interest between providing services for members and providing profits for shareholders. The different models directly impact on returns to members, as can be evidenced by the different approaches and outcomes from UK and Australian schemes:
   a. Most UK master trusts (the only exceptions are Nest and People's) are run by for-profit firms, who earn fees by providing services to the scheme. Large schemes are either close to making a profit or doing so already; for example Marsh MacLennan (owners of Mercer, who sponsor a large master trust) had a net profit margin of 16% in the last 12 months for which data is available, and would seek to make similar margins from their master trust. If such a net profit margin was instead re-invested into the scheme, it would significantly enhance returns to pensions savers.
   b. In Australia many of the super funds operate on a profit-to-member model. We understand that the evidence in Australia is very clear that profit-for-member schemes deliver better returns than commercial schemes.

[2] https://assets.publishing.service.gov.uk/media/673f3ca459aab43310b95a8d/pension-fund-investment-uk-economy.pdf
[3] https://www.mckinsey.com/industries/private-capital/our-insights/is-big-really-beautiful-the-limits-of-pension-consolidation

8. It will be important to ensure that there is broad acceptance and support for consolidation, not just from the pensions industry but from employers, trade unions and, most importantly, employees.

In relation to the government's aim of **driving more productive investment in the UK**, we would like to make the following observations:

9. In principle, ShareAction is in favour of encouraging investment in the UK and of enabling pension schemes to invest in the UK. This should help drive UK growth and is usually popular with pension scheme members, for example where LGPS invests in local initiatives that boost the local economy.

10. We would like greater clarity on what the government means by the term "UK investment". This should not necessarily mean investing in firms that are listed in the UK, some of whom have negligible numbers of UK employees; nor should it equate to investing abroad via investment in asset managers or private equity firms domiciled in the UK. We consider that the concept of 'UK investment' should be investment targeted at *economic activity* in the UK, especially given this government's commitment to kickstarting economic growth and raising living standards in every part of the UK.

11. Asset allocation and the drivers of asset allocation changes are complex, and the government will need to consider these carefully if it is to successfully promote pension scheme investment in UK assets. A recent report by PPI comments that "mapping the assets of the UK pension sector is like trying to nail 20 jellies to a wall"[4].

12. Relative financial performance has been a key factor causing UK pension schemes to invest outside the UK. It is well-documented and widely acknowledged that US shares in particular have significantly outperformed UK shares in the 2010s and especially in the 2020s. It is therefore objectively justifiable that more UK pension fund money has been invested into US stocks (for example, the "Magnificent Seven") than into UK equities. The implication of this is that increasing UK investment could be at odds with increasing saver returns.

13. The DWP's recent report "Pension fund investment and the UK economy" as cited above refers to recent work conducted by the Government Actuary's Department for DC schemes to consider the potential member impacts of different asset allocations and UK asset class exposures. The report notes that:
    a. In relation to UK equity exposure: *"It is recognised that UK equities have underperformed overseas equities over the recent past, by approximately 4 percentage points per year over the last 20 years" and that "UK-focussed strategies would be expected to underperform the Baseline and result in smaller pot sizes were recent past market conditions to persist."*
    b. In relation to private markets exposure: *"An asset allocation with a greater level of exposure to private markets may deliver slightly greater returns to members (up to 2%*

[4] https://www.pensionspolicyinstitute.org.uk/media/c00dra0k/20240909-ppi-pension-scheme-assets-main-report-final.pdf

> *greater pension pot compared to a baseline scenario). However, there is considerable uncertainty, particularly around the extent future performance will differ compared to past performance."*[5]

14. One of the problems for pension funds is identifying good investment prospects in the UK. Helpfully, the Pensions and Lifetime Savings Association has recently produced a report entitled "Pensions and growth: creating a pipeline of investable UK opportunities". The report notes that mobilising pension fund investment into UK productive finance has the potential to result in significant, tangible, real-world benefits for society. Key projects include green projects such as investment in wind and solar, and scaling up the market for heat pumps and electric vehicles. The paper also includes proposals for government policies such as planning reform which will help make these assets more investable.[6]

15. The Terms of Reference for the pensions review do not mention green growth, which is surprising at a time when the government is seeking to boost productive investment and following Labour's commitment to making the UK a 'clean energy superpower' and creating 650,000 new green jobs. Recent research by the Energy and Climate Intelligence Unit and the CBI concluded that even under the Sunak government the net zero sector outperformed the economy generally:
    a. The UK's net zero economy grew 9% in 2023, in stark contrast to the 0.1% growth seen in the economy overall.
    b. The net zero sector contributed £74 billion of gross value-added, and net zero businesses attracted £14 billion of foreign direct investment.
    c. Jobs in the net zero economy are highly productive, generating £114,300 in economic activity. Net zero jobs are better paid by almost £10,000.[7]

16. Responsible investment by UK pension schemes has enormous potential both to drive sustainable growth and deliver stable returns for UK pensions savers. It also presents an opportunity to take a truly cross-government approach which directly supports the government's broader missions and programme of national renewal. For example, granting pensions schemes the freedom to invest specifically in community projects would support the mission to deliver local and regional growth, and to put place at the heart of its Modern Industrial Strategy. Encouraging schemes to invest in new infrastructure over continued funding for fossil fuels would support the mission to achieve energy security and clean power and to create new net zero jobs. And empowering schemes to prioritise investment in companies which treat their workers better or produce healthier products would support the mission to make work pay and tackle the root causes of ill health.

17. Place-based impact investing or local impact investing should also be encouraged. Place-based impact investing has been defined as "Investments made with the intention to yield appropriate risk-adjusted financial returns as well as positive local impact, with a focus on addressing the needs of specific places to enhance local economic resilience, prosperity and sustainable

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[5] https://assets.publishing.service.gov.uk/media/673f3ca459aab43310b95a8d/pension-fund-investment-uk-economy.pdf
[6] https://www.plsa.co.uk/Portals/0/Documents/Policy-Documents/2024/Pensions-and-Growth-Report-PLSA-2024.pdf
[7] https://eciu.net/analysis/reports/2024/the-uks-net-zero-economy-2024

development."[8] An example of local impact investing is the Greater Manchester Pension Fund which has achieved good financial returns from backing projects which also had positive employment, social and physical fabric impacts.

18. If the government were to pursue policies that would make UK investments more attractive in the short-, medium- and long-term this should enable higher levels of investment, including by UK pension schemes. We suggest that fiduciary duty clarification and the regulation of strategic asset allocation advice by investment consultants would both be helpful levers for encouraging UK investment for the reasons outlined below.

<u>Chapter 3 – Contractual override without consent for contract-based arrangements</u>

19. This is not an area that ShareAction has direct experience of engaging on, however we would urge HMT and DWP to ensure that consumer safeguards and protections are put in place and that risks to consumers are minimised and mitigated.

<u>Chapter 4 – Costs versus Value: The role of employers and advisers</u>

20. We would like to make the following points in relation to Question 30 on Employers and Question 32 on Regulation of advice, in particular the regulation of investment consultants.

Employers
Question 30: What evidence is there that placing a duty on employers to consider value would result in better member outcomes? If such a duty was introduced, what form should it take? Should it apply to a certain size of employer only? How can we ensure it is easier for employers to make value for money comparisons?

21. ShareAction previously responded to the Value For Money Framework Consultation published on 8th August 2024. In general, ShareAction considers the FCA's efforts to broaden Value for Money (VFM) beyond costs and charges of services to be a very positive development.

22. In such a context it is clearly vital to look at risk-adjusted returns in addition to costs and value. For example, although the returns from private equity may be higher, the risks tend to be significantly higher than for other asset classes and the fees are much higher. For many private equity firms a 'two-and-twenty' fee structure is common, which means a 2% management fee plus a 20% performance fee above the hurdle rate, versus a 0.05% fee payable to Blackrock for an index investment.

23. ShareAction is concerned that the proposals outlined in the VFM consultation do not include metrics to disclose and compare sustainability performance by pension schemes.
    a. Savers want to see their pension scheme make investments that reflect their beliefs. YouGov research undertaken in 2023 showed that 73% of people wanted either more, equal weight or some consideration to be given to the social and environmental impacts

[8] https://www.impactinvest.org.uk/learning-hub/place-based-impact-investing/what-is-place-based-impact-investing/

of their investments, compared with financial returns.[9] Environmental and social impacts of investments is something that matters to savers, thus it is of value.

b. Part of 'good' investment advice would be to take account of such preferences where possible and where they are consistent with good outcomes. This would suggest not adopting a cookie-cutter approach to every scheme and the technology certainly exists to gain insight into member views (although the most challenging aspect may be to get member engagement).
c. It would not represent true long term 'value for money', especially for younger people who are now being auto-enrolled in pensions, if their scheme performed well on the basis of financial and service metrics in the short term but was also contributing to longer-term risks and financial losses as a result of, for example, climate change and deforestation.
d. The management of system-level risks and opportunities, including those related to climate, health, workers' rights etc, should deliver financial value and help minimise risks and potential financial losses.

24. ShareAction considers that a long-overdue change that would drive better member outcomes is the legal clarification of fiduciary duty. By updating one regulation (the Occupational Pension Schemes Investment Regulations 2005), it could be made clear that pension funds should consider and manage financially material considerations and system-level considerations, including climate change, and their pension scheme's investments' impact on financial systems, the economy, the community and the environment. Such a legislative change would create a more enabling environment for pension funds to support a thriving UK economy for pensions savers to retire into while giving trustees the legal clarity needed to make investment decisions in the best interests of pensions savers.

25. Limiting climate change and investing in the local economy are both in principle in the interests of UK pension investors but a key problem will be identifying investments which represent good value (in a broad sense) and are not promoted to schemes on the basis of weak/false analysis, and this is where good advisers could provide very valuable advice.

26. The aspect of fiduciary duty clarification which may make the most significant difference to saver outcomes is the consideration of beneficiary quality of life/standard of living. System-level risks are global, and a pension scheme that is more heavily exposed to the US than the UK has more financial incentive to address US/global system-level risks than UK-specific ones; by contrast, beneficiary quality of life/standard of living would be UK-focused.

27. A small change that might have a significant impact on member outcomes is that currently employers do not have to enrol individuals for three months from the start of employment unless the individual requests it. If the average person has 11 jobs that is 33 months of contributions they don't make in a lifetime; for Gen Z this could be 18 jobs in their lifetime[10], which would mean 4.5 years of missed contributions and the long term accumulated growth from these contributions. We would therefore encourage the government to consider requiring enrolment of employees into company pension schemes when they start work rather than three months later.

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[9] https://shareaction.org/news/british-public-concerned-by-banks-socially-and-environmentally-harmful-investments-exclusive-poll
[10] https://www.moneydigest.com/1640035/how-many-more-jobs-millennials-gen-z-generations-will-work-in-lifetime/

Regulation of advice
Question 31: What evidence is there that regulating the advice that some employers receive on pension selection will better enable them to consider overall value when selecting a scheme?

Regulation of advice
Question 32: What evidence is there that regulating the advice that pension schemes receive on investment strategies would enable more productive asset allocation? What type of regulation would be effective?

28. We will respond to questions 31 and 32 together in the context of the need for more oversight of advisors and in particular the need to close the existing regulatory gap in relation to investment consultants.

29. The DC consultation document acknowledges that:
    a. There can be significant variation in performance across pension providers (paragraph 102).
    b. Professional advisers can play a significant role in influencing the decisions taken by multi-employer pension schemes in relation to cost and investments (paragraph 107) and Investment consultants, in particular, play an important role in advising pension scheme trustees on their investment strategy (paragraph 120).
    c. At present, there is no specific regulatory regime regulating the services provided on pension scheme selection advice or investment consultancy (paragraph 119).
    d. The government wants to understand exactly to what end and how new regulation could play a role in ensuring that advice consistently considers returns alongside costs to ensure that the best interests of pensions savers are being served (paragraph 122).

30. Last year, ShareAction wrote to HM Treasury urging the regulation of investment consultants. We noted that on numerous occasions over the last ten years the Financial Conduct Authority, the Competition and Markets Authority, parliamentary committees and other interested parties have called for investment consultants to be brought within the FCA's regulatory perimeter. Please see the following link for the full text of our letter to HM Treasury. https://shareaction.org/policies/hm-treasury-should-expedite-the-regulation-of-investment-consultants

31. The government has publicly stated repeatedly that there will be a presumption that the government will accept all the CMA's published recommendations unless there are strong policy reasons not to do so. The government did accept the CMA's recommendation, has never provided policy reasons for not doing so, and yet has still not yet regulated. We consider that this is a necessary regulatory requirement that is long overdue, and if the government does not accept the recommendation to regulate investment consultants it should provide a justification.

There are several reasons why we consider that the regulation of investment consultants is needed and why this should happen as part of the current pensions review

32. We have not been able to identify any other area of financial services where investors are required by regulation to seek - and in effect follow - advice, but the people providing that advice are not required to be regulated.

33. Under section 36(3) of the Pensions Act 1995, pension scheme trustees "must obtain and consider proper advice on the question of whether the investment is satisfactory". Pension schemes are therefore explicitly legally required to seek advice and – because of the legal risk of doing otherwise – will follow this advice. However, despite the fact that this is advice which is required by law, it is only regulated to a limited extent.

34. The FCA currently regulates some, but not all, investment consultancy services. Investment consultancy services which are not regulated activities include advice on investment strategies, manager selection and asset allocation, and advice on the suitability of a fiduciary management service or provider. The unregulated activities of investment consultants significantly influence the investment decisions taken by UK pension schemes and will have a significant impact on pension scheme outcomes.

35. Advice on strategic asset allocation is one of the most important aspects of investment consultancy advice:
    a. Strategic asset allocation determines the assets within a pension scheme portfolio;
    b. Strategic asset allocation is a key determinant of the likely returns of the pension scheme; and
    c. Strategic asset allocation can also influence markets in general (for example, the widespread adoption of the LDI approach).

36. Given the general importance of strategic asset allocation advice it seems illogical and unjustifiable that this is one of the services that is not regulated. Furthermore, given the government's current focus on expanding asset allocation and encouraging pension investment into UK assets, the issue of strategic asset allocation will become increasingly important.

37. Pensions schemes tend to have relatively few in-house staff and often rely heavily on advisors and investment consultants in particular. However, the Competition and Markets Authority found a number of features of the market that restrict or distort competition in connection with the supply of investment consultancy services to UK pension schemes. The CMA considered that these adverse effects on competition could be expected to result in substantial customer detriment.[11]

38. The investment consultancy market is relatively concentrated and the market power of certain players will be further increased following recent acquisitions, including the acquisition of Cardano by Mercer.

[11] https://assets.publishing.service.gov.uk/media/5c0fee5740f0b60c8d6019a6/ICMI_Final_Report.pdf

39. There are concerns about potential conflicts of interest within the sector:
    a. There is a potential conflict of interest when investment consultants are both assessors of asset managers and also seeking to provide services as the fiduciary manager of assets themselves.
    b. There is also a potential conflict of interest where investment consultants offer their own Master Trusts. As an illustrative example, Mercer is one of the biggest investment consultants in the UK and it provides advice to a large number of UK pension schemes but it also runs its own DC Master Trust and its own DB Master Trust.

40. As noted above, there can be significant variation in performance across pension providers. Paragraph 102 and footnote 28 of the consultation document refers to CAPADATA produced by Corporate Advisor and 5-year annualised percentage returns for younger savers. A report produced by Corporate Advisor in 2023 has more detailed data on performance and asset allocation of Master Trusts and GPP Defaults. The charts in chapter 2 of this report show a huge divergence in the returns of different pension schemes (see for example, figures 13, 14, 15, 19, 20, 24 and 25).[12] There are clearly significant divergences in returns which would mean substantial differentials in outcomes when compounded over a pension saver's lifetime. Investment consultants' recommendations to their trustee clients will have a big impact on member outcomes given this wide variety of performance, so it is important that these decisions - which are rarely revisited and never reversed - are conflict-free.

41. Pension schemes have a duty to identify and act on significant systemic risks which could have a material financial cost to their portfolios. Such advice should be, but may not always be, appropriately included in the advice that pension trustees receive from their investment consultants. The regulation of such advice would enable parameters to be developed and assessed to ensure the provision of suitable advice on systemic risks to pension trustees.

42. The investment consultancy industry has faced criticism for the use of economic scenario models which significantly underestimate both the scale of future climate-related damages and the near-term risks of such damages occurring due to the failure to include climate tipping points in their models, which may result in incorrect investment advice. The Institute and Faculty of Actuaries has stated that many climate-scenario models in financial services are significantly underestimating climate risk, in particular because the real world impacts of climate change, such as the impact of tipping points, are largely excluded.[13] There is also concern about the use by investment consultants of Integrated Assessment Models which have been criticised for their flawed analysis of the impact of climate change on investment returns and the inaccuracy of their forecasts. We would encourage the government to consider an inquiry or evidence session to examine the extent of the use of inaccurate climate scenario models and the erroneous investment advice which may result.

[12] https://corporate-adviser.com/ca-master-trust-gpp-defaults-report-key-findings/
[13] Institute and Faculty of Actuaries, July 2023, "The Emperor's New Climate Scenarios: Limitations and assumptions of commonly used climate-change scenarios in financial services" https://actuaries.org.uk/news-and-media-releases/news-articles/2023/july/04-july-23-emperor-s-new-climate-scenarios-a-warning-for-financial-services/

43. In addition to seeking consolidation for DC pension schemes the government is also consulting on delivering a major consolidation of Local Government Pension Schemes. Proposed changes to LGPS arrangements will lead to a smaller number of bigger funds which will be regulated by the FCA but which will still be obtaining advice from investment consultants who might not be regulated. We note that the risk of poorer member outcomes (both financial and otherwise) is far more acute in the context of plans to consolidate schemes whose advice will continue to be provided by unregulated firms.

44. The current LGPS consultation includes the following proposals for administering authorities (AAs) and pools:
    a. AAs would remain responsible for setting an investment strategy for their fund, and would be required to fully delegate the implementation of that strategy to the pool.
    b. AAs would be required to take principal advice on their investment strategy from the pool.
    c. Pools would be required to be established as investment management companies authorised and regulated by the FCA, with the expertise and capacity to implement investment strategies.

45. The LGPS consultation notes that currently, 5 of the 8 pools are established as FCA authorised investment management companies. The government proposes that all pools should be established as investment management companies and all such companies would require FCA authorisation. The consultation states that not all pools have the existing capability to provide advice to the AAs; full advisory capability, or the means to share advisory capability across pools, would need to be developed over time and that in the meantime, the government expects that pools would seek to procure advice on behalf of their partner funds. It seems reasonable to suppose that such advice would be sought from investment consultants which then makes it surprising to require pools to become authorised and regulated by the FCA without also requiring the firms who advise the pools on their investments to also be authorised and regulated by the FCA.

Question 31 of this consultation asks "What evidence is there that regulating the advice that some employers receive on pension selection will better enable them to consider overall value when selecting a scheme?"

46. This role is provided by Employee Benefit Consultants (EBCs) but many EBC firms, including the predominant EBC firms, are the same as the investment consultancy firms.

47. Advice to employers is different to advice to trustees so to include all relevant advice the government needs to bring Employee Benefit Consultants into regulation alongside investment consultants. Given the similarities between the roles of investment consultants and EBCs it seems reasonable to close regulatory gaps in both markets.

48. This would still leave small employers out as they tend not to be advised at all and probably select on the basis of who their payroll provider will engage with. The schemes they are likely to pick, including the big master trusts, perhaps need to do more to understand their membership.

Question 32 of this consultation asks "What evidence is there that regulating the advice that pension schemes receive on investment strategies would enable more productive asset allocation? What type of regulation would be effective?"

49. Paragraph 121 of the consultation states that some respondents noted that this form of regulation would mean that advisers are required to consider the value of schemes or investment strategies in their advice, which could mean a lesser focus on cost.

50. We are aware that a number of UK pension schemes, individually and as industry groups, have told HM Treasury that investment consultants should be regulated. ShareAction would not assert that we can speak on behalf of UK pension schemes but for the purposes of this consultation we note the following indicators that not all investment consultants are providing good advice to pension schemes:
    a. The Competition and Markets Authority's extensive investigation into this market and the CMA's findings of an adverse effect on competition in the UK and the need for a package of remedies to remedy the resulting consumer detriment.
    b. The ongoing conflicts of interest and the potential for increasing conflicts given consolidation and the growth of master trusts.
    c. The significant variability of investment returns.
    d. The use of inaccurate climate scenario models.
    e. Anecdotal evidence of pension funds switching advisors due to dissatisfaction with the quality of advice provided.
    f. Recent research showing that pension funds overpay £1.5bn in fees to fund managers, with a wide range of charges for the same product and some schemes paying up to 14 times more for the same product than other schemes.[14]

51. We consider there are several important reasons why investment consultants should be regulated. Please see paragraphs 32-45 above for a full list of these reasons, which go broader than the issue of productive asset allocation specified in question 32 of the current consultation.

52. We would also suggest that regulation of investment consultants should support the government's broader objectives and ambitions:
    a. Regulation of consultants should support the government's objectives around scheme consolidation, given that consultants do not have much of an incentive to be helpful in this regard (more schemes means more clients for consultants).
    b. Regulation of consultants should help the government's ambition to secure better long term outcomes for UK savers by enabling more consistent and high quality advice through regulatory supervision of that advice.
    c. Regulation of consultants should help the government's objective of mobilising private capital for low carbon transition by enabling more consistent and high quality climate modelling to underpin the advice received by schemes.
    d. Regulation of consultants should support the government's objective of seeing more UK pension capital allocated to UK productive assets.

53. In relation to productive asset allocation, this assertion is somewhat difficult for ShareAction to substantiate with evidence because strategic asset allocation advice is not currently regulated so

[14] https://www.ft.com/content/211337ca-c31c-4eea-898a-12192490151c

there is very little information publicly available on the advice that is given, what the content of such advice is, or how it drives the investment decision-making of UK pension schemes.

54. However, it is reasonable to note that consultants' influence over strategic asset allocation by UK pensions schemes is highly relevant. It is also reasonable to consider that consultants' advice has driven pension capital out of UK assets over the last decade.

55. We therefore consider that regulation and oversight of the strategic asset allocation advice provided by investment consultants should assist in enabling more productive asset allocation. We think it is reasonable to assume that the regulation of strategic asset allocation would give comfort to schemes to invest in a wider range of assets in the UK. In particular, private equity and other longer-term investments tend to be more risky and have a more uncertain and potentially a more volatile profile. Such assets will certainly have a different risk-return profile to the investments normally made by the majority of pension schemes. Regulation and oversight of advice on strategic asset allocation should help mitigate some of these risks and encourage pension schemes to have more confidence in investing in a broader range of assets.

56. We note the government's wish to drive consolidation as this is seen as an effective means for increasing productive asset allocation. However as also noted above, there are wide disparities in pension scheme performance and consolidation does not necessarily mean better returns for pensions savers. It seems to us that it is necessary to gather more evidence on scale, performance and the quality of the investment advice provided to pension schemes and use this to drive up investment performance and returns for pensions savers. Consolidation is necessary but appears to be insufficient to drive up investment performance; to ensure alignment with beneficiary interests along the length of investment chain, it is necessary that the determinants of pension scheme investment decision making are brought into the FCA's remit. The regulation of investment consultants and the assessment of the quality of the advice that they provide to pension schemes therefore is a necessary aspect of driving up standards and outcomes for pensions savers.

57. Regarding the type of regulation that would be effective, this should be determined by HMT and the FCA. However we would think that the following approach would be reasonable:
    Step 1: Add regulated activities and include all those not currently regulated at all.
    Step 2: Once all firms are regulated, the FCA would need to assess conduct and advice provided e.g. look at whether investment consultants are actually providing bespoke advice to that client and potential conflicts of interest.
    Step 3: Implement specific rules in the FCA Handbook based on what is going wrong or not working well.

58. Once investment consultants have been brought into regulation, regulators could then proceed to conduct more detailed assessments of the reasonableness of the methodologies adopted by investment consultants. Such an assessment would assist the regulator in determining whether investment consultants are advising on overall value rather than cost or other metrics.

59. It would be worth including in legislation the ability/requirement for the FCA to put requirements on investment consultants (and EBCs) to consider environmental and/or wider sustainability issues when giving advice, alongside the necessary updating of the law relating to fiduciary duty.

Chapter 5 – Impacts & Evidence

60. We are pleased to note that you are seeking additional evidence on the above points, in addition to that previously provided by respondents in the earlier Call for Evidence.

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Pensions Review phase two

61. We are pleased that pensions reform is now a political priority. It is crucial that pensions reform ensures that all savers can look forward to adequate pensions throughout retirement, and that pension fund investments help us to achieve a just transition to a truly sustainable and productive economy.

62. In collaboration with other civil society organisations we have produced a joint briefing which sets out pensions reforms that would deliver on these interlocking objectives, including:
    a. Boost pension savings and the state pension to ensure adequate retirement incomes for all and support a fairer, stronger economy.
    b. Make pension funds longer-term investors.
    c. Support pension funds to drive green investment in the UK.
    d. Green the system and phase out fossil fuel investment.
    e. Enhance transparency and accountability.[15]

63. We are disappointed at the news of the likely delay to the second phase of the pensions review. We are concerned in particular about the review of pensions adequacy. We consider any delay to be surprising and contrary to the Minister's stated aim in this consultation to want to deliver better outcomes for future pensioners and investment into the UK economy.

64. We note that concerns about a delay to phase two of the pensions review were raised in debate in the House of Lords on 18 December 2024 and that Baroness Sherlock, the Parliamentary Under-Secretary of State for the Department for Work and Pensions, reiterated that the government is committed to a second phase focused on pensions adequacy and further measures to improve outcomes for pensioners.[16]

65. We are concerned that the Terms of Reference for the pensions review does not mention responsible investment. UK pension funds hold over £3 trillion in assets and are major investors. Unfortunately, many pension funds are not only failing to adequately manage climate risks and other systemic risks such as biodiversity loss, but they are actively contributing to them through continued investment in fossil fuel expansion and deforestation. This near-sighted approach poses a real threat to the UK's future economic stability and UK savers' quality of life in retirement. Action on these risks should enhance returns, short and long term, by better managing system-level risks, exploiting opportunities and enhancing member quality of life through stronger, fairer, more resilient economic growth.

[15] https://shareaction.org/policies/better-pensions-for-all-proposals-for-reform
[16] https://hansard.parliament.uk/lords/2024-12-18/debates/EE1AA7F6-F214-4D9B-8D81-44D96F0D3C27/PensionReviewPhase2

66. ShareAction favours a change in the law as the most effective means of definitively addressing the real and perceived legal obstacles to responsible investment. Fiduciary duty should be updated to integrate consideration of the impact of a scheme's investments alongside the existing duty to balance risk against return. Such changes in the law would provide absolute reassurance to a pension fund wanting to pursue responsible policies that it is permissible, indeed desirable, to do so. Our briefing paper "In All Our Best Interests – Reforming Fiduciary Duty for the 21st Century" sets out why policymakers should clarify and expand fiduciary duty.[17]

67. We are currently engaging with pensions lawyers and pension schemes on the draft wording for a change in the law and we will discuss this with DWP and HMT officials in due course.

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[17] https://shareaction.org/policies/in-all-our-best-interests-reforming-fiduciary-duty-for-the-21st-century