Written evidence submitted by the Investment Association (PSB51)

Pension Schemes Bill: Call for Evidence

1. The Investment Association[1] is grateful for the opportunity to respond to the House of Commons' Public Bill Committee's call for evidence on the Pension Schemes Bill.

2. We are supportive of the overall direction of travel of the reforms, with a more consolidated pension system that is better able to deploy capital through enhanced scheme governance and investment processes. Our central concerns relate to some of the mechanisms being used to achieve this outcome, and their implications for both pension schemes and ultimately scheme members. These relate entirely to the section of the Bill that concerns the Defined Contribution (DC) pensions market.

Summary of comments on selected DC-focused provisions of the Bill

3. The measures in the Bill risk leading the DC pensions market to become **overly concentrated, reducing competitive pressure and innovation**. To prevent this, regulators will need to monitor, and if necessary, exercise their competition powers, where they exist. We highlight potential systemic risks arising from asset concentration that could amplify negative impacts in a crisis. A principles-based supervisory approach to consolidation, focused on governance and the quality of scheme investment processes is a way to foster better outcomes and resilience in the DC investment sector.

4. **Mandating DC asset allocation to private assets likely conflicts with trustee fiduciary duty and providers' Consumer Duty obligations. It comes with significant risks for members** in the form of capital being poorly allocated if political preferences take priority over member needs. Any resulting poor investment outcomes will be borne by the member. By creating the risk of political interference in capital allocation, the power undermines the UK's global reputation as a predictable and rules-based investment environment, making it a less attractive proposition for both domestic and foreign investors. We propose removing the power to mandate asset allocation from the Bill entirely. If the power does remain in the Bill, there are urgent issues that need to be addressed, such as the current exclusion of closed-ended investment companies, the setting of an earlier expiry date, and much stronger safeguards around its' use.

5. **The focus in the Bill on pension scheme investments in private markets distracts from the need to consider the UK's capital markets in a holistic manner**: private markets need healthy public markets as an exit strategy and the regulatory

[1] The Investment Association (IA) champions UK investment management, a world-leading industry which helps millions of households save for the future while supporting businesses and economic growth in the UK and abroad. Our 250 members range from smaller, specialist UK firms to European and global investment managers with a UK base. Collectively, they manage £9.1 trillion for savers and institutions, such as pension schemes and insurance companies, in the UK and beyond. 49% of this is for overseas clients. The UK asset management industry is the largest in Europe and the second largest globally.

messaging around pension scheme investment in productive assets should extend to listed investments too.

6. There is a need for **greater clarity in the policy on retirement income**, particularly regarding the interaction between Targeted Support and the ‘default pension benefit solutions’ that the Bill requires DC schemes – both trust and contract-based – to provide. We set out our support for the FCA’s proposals to introduce Targeted Support as a means to better engage and guide customers in making informed retirement decisions, emphasising that default solutions alone cannot adequately address the diverse needs of pension scheme members. Targeted Support should be the primary intervention, with default pension benefit solutions serving as a backstop for those who opt out of Targeted Support.

7. In addition, we have three overarching comments about the Bill:

    - **DC market regulation should ensure a consistent experience for members** across both FCA and TPR-regulated pension schemes, and the Bill should support this principle.

    - **Provisions to vary primary legislation**: there are many provisions in the Bill that allow Statutory Instruments to amend sections of the Bill. We urge due consideration of when such powers are appropriate and the strength of both parliamentary scrutiny and industry consultation before any changes are made. In particular, the Bill Committee can assist here by ensuring the government provides more detail on the proposed policy as the Bill is debated. We highlight a number of areas below where such scrutiny would be especially beneficial.

    - **Delivery and implementation timelines**: we urge the government to take a pragmatic approach to the timing of implementation of the measures in the Bill. The complexity of issues that will need to be addressed through secondary legislation and rules, alongside ongoing operational demands and the existing pipeline of initiatives, such as pension dashboards, means that realistic and well-planned sequencing of legislation is essential. As much of the detailed policy will be in secondary legislation, early clarity through scrutiny of government policy is crucial to help schemes and providers prepare effectively.

<u>The impact of the minimum scale requirements on competition and innovation in the DC market</u>

8. We share the government’s view that fragmentation in the DC system – especially the high number of very small schemes – needs to be addressed. However, any measures to do so must avoid unintended consequences. Setting a minimum threshold in legislation for Assets under Management (AuM) or limiting the number of default funds may incentivise 'asset gathering' over innovation and negatively impact smaller, innovative providers seeking to enter (or remain in) the market.

9. Given the scale expected in this market we have significant concerns that the DC market could end up looking like a utility-type market of few providers with little differentiation between them. With the near-guarantee of significant on-going inflows purely as a result of being one of the few remaining providers, we see little competitive pressure to innovate. This concern is heightened when further combined with application of the proposed DC Value for Money Framework. As we set out in our response[2] to the FCA's October 2024 consultation[3] on the Framework, cross-scheme comparisons, the 'Red-Amber-Green' ('RAG') rating process and the new business ban in combination will have significant detrimental consequences for market innovation, with DC schemes best served by not standing out from one another. This may lead to herding in investment strategies across the market and a lack of innovation in DC investment, not more. This may be particularly negative for the government's desire to see both greater allocations to private assets and more innovation in retirement income products.

10. We recognise that the government has sought to address these concerns in the Bill with the inclusion of the 'Transition pathway relief' and 'New entrant pathway relief' amendments to The Pensions Act 2008[4]. However, the precise criteria that regulators may use in assessing schemes within these pathways are currently unknown, as they will be set in secondary regulations, and so it is not yet clear that these pathways will preserve the dynamism of the market.

11. Indeed, the market will need careful monitoring by competition authorities to mitigate the risks set out above. In this regard, we note that there is a complex regulatory landscape for pensions, given that FCA does have formal competition responsibilities, but TPR does not. Although we envisage there would be a role for the Competition and Markets Authority at an overarching level, it is worth considering how best to embed the need to avoid over-concentration and a lack of competition into the regulatory oversight of the pensions system as a whole.

12. Systemic risks are a further concern. A concentration of assets with a small number of providers, in the event of a provider failure or market crisis, could have highly negative impacts on member outcomes and damage confidence in the DC industry. This may be heightened if the lack of competitive dynamics highlighted above results in herding in DC investment strategies, in which case all schemes will see similar negative impacts from the same market shock. The correlation of such outcomes will mean the entire DC sector being badly affected.

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[2] IA response to FCA CP24/16

[3] CP24/16 'The Value for Money Framework', FCA, 2024

[4] Part 2, Chapter 3, Clause 38(12) of the Bill, which introduces sections 28D and 28E to The Pensions Act 2008.

13. A principles-based supervisory approach that emphasises scale and relies on consistent and high standards of scheme governance (including appropriately diversified investment strategies), rather than a fixed numerical target, could better support the development of high-quality, diversified investment strategies. This could also be designed to drive consolidation among smaller schemes unable to demonstrably meet these standards. Regulators should monitor scale metrics but prioritise governance to enhance the DC investment process and engage with DC schemes to support them in building these high-quality governance processes.

14. A further way to preserve dynamism within the market would be to ensure the Bill allows for third party provision of Main Scale Default Arrangements (MSDAs). The current approach in the Bill requires each provider to have at least one MSDA that meets the minimum scale requirement by 2030. This state can be reached faster and equally as effectively by allowing third party providers (i.e. those not necessarily linked to the same or to related service providers) to distribute common MSDAs. This will allow a broader set of firms to compete in the DC market, helping to preserve choice and innovation for employers and scheme members: It offers investment managers the opportunity to compete to provide MSDAs, and, by achieving the requisite scale at the level of the MSDA, allows a broader group of pension providers to compete in the market.

15. The current wording of the new clauses 28A and 28B (added by Clause 38(12) of the Bill to the 2008 Pensions Act) allow for a master trust or GPP to distribute a MSDA managed by a third party, as long as the MSDA met the minimum scale requirement. We would welcome explicit clarification of this. Our understanding is that there is interest from potential providers of MSDAs to distribute them through third party schemes and believe this should be explicitly allowed for within the Bill to encourage a route to scale for innovative schemes.

16. At a technical level in the legislation, while it is clear that providers are expected to have at least one approved MSDA with at least £25bn of assets (by 2030) subject to a "common investment strategy", we have identified a number of cases where some types of workplace pension arrangements that are currently used for automatic enrolment would not be counted towards the £25bn threshold, when they should be.

17. According to clause 38(14) of the Bill, the following types of arrangement would not count towards the minimum scale threshold:

    - Stakeholder pension schemes. This would affect providers who offer group stakeholder pensions and a group personal pension (GPP) where both use a common investment strategy.

- Providers running more than one Master Trust using a common investment strategy. This occurs when providers consolidate, but the schemes are still run as separate entities. Given the scale agenda, this is likely to be a frequent occurrence.

In both these instances, scheme assets are run on a common investment strategy, such that the required scale can be achieved at the default level. However, since these scheme types are excluded from the definition of Group Personal Pensions in the Bill, they will not count towards the £25bn threshold. This should be corrected such that these arrangements become eligible to be counted towards the threshold, otherwise there is a risk that some providers could be locked out of the market.

In addition to these cases, the definition of a GPP within the Bill excludes 'any pension scheme that gives a member the power to direct how some or all of the member's contributions are invested.' The majority of GPPs within the UK market will have a default arrangement, as is required to be a qualifying scheme for automatic enrolment, but they will also offer members the ability to self-select investments if they desire. This definition therefore effectively disqualifies any GPP used for automatic enrolment, which we do not believe was the government's policy intention. As such, the definition should be amended to ensure that the default arrangements of GPPs that also offer self-select investment options are eligible for inclusion in the £25bn threshold.

The reserve power to mandate asset allocation

18. We do not believe a power to mandate asset allocation is appropriate or necessary to achieve the government's intention of seeing greater DC investment in UK private assets.

19. We have previously[5] set out our view that higher levels of UK investment can be driven through a combination of measures, including the creation of 'sophisticated scale' at pension schemes[6], increasing allocations to private market investments[7], and a focus on reforms to enhance the attractiveness of UK capital markets, including appropriate tax incentives, where the fiscal position permits it. Looking back at both the UK and other international pension markets, for example Australia, it is clear that specific tax incentives[8] can play a role in helping to steer capital flows.

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[5] 'Investing for Everyone's Future – A response to the Pensions Investment Review: Call for Evidence', The Investment Association, 2024.

[6] By which we mean a focus on developing enhanced investment expertise, governance and implementation as pension schemes grow in size.

[7] There is some evidence to suggest a 'home bias' when initially allocating to private markets, albeit this decreases as pension schemes increase in size. See the section on 'Investing in the UK' in the IA's response to the 'Pensions Investment Review: Call for Evidence'.

[8] See for example the use of the Enterprise Investment Scheme (EIC) or Venture Capital Trust (VCT) in the UK.

20. In addition, meeting the government's desire for greater public and private infrastructure investment (ranging from sustainable energy projects to housing), will require a new approach to facilitating supply. There is a range of experience over the past decade that points to a central issue being an ongoing mismatch in expectations between UK pension (primarily DB) schemes looking to deploy capital and the availability of attractive projects. The government's focus on addressing supply-side bottlenecks is therefore welcome.

21. It is also important to emphasise that for long-term investors such as pension schemes, whose time horizons stretch over decades, long-term certainty of direction of travel and 'rules of the road' is essential. Problems have arisen in the past where investment managers acting for investors including pension schemes have encountered unexpected policy shifts which impact this certainty and therefore investment confidence.

22. Mandating asset allocation does not address these points, and in addition, comes with significant risks. First and foremost, the investment case for any allocation has to be clear from a fiduciary perspective. A government decision to require investment in particular asset classes and geographies clearly risks violating both fiduciary duty and provider obligations under the FCA's Consumer Duty.

23. More broadly, by creating the risk of political interference in capital allocation, the power undermines the UK's global reputation as a predictable and rules-based investment environment, making it a less attractive proposition for both domestic and foreign investors.

24. A hard mandate is difficult to calibrate across the DC system as a whole, and risks potentially channelling large amounts of capital into poor prospective investments if there is too much money chasing too few investment opportunities.

25. These risks are especially heightened in DC, since this is the element of the pension system where individuals bear the most risk. It is DC investors that will bear the risk of poor investment outcomes arising from mandated asset allocation. This is exacerbated by the fact that the DC element of the UK pension system is where the greatest adequacy risks[9] lie, as result of the low contribution rates that characterise the DC system. The government risks creating a two-tier system, whereby those who are informed and confident enough to make their own investment decisions, or can afford financial advice, and wish to avoid the risks posed by mandated asset allocation, choose to opt out of default arrangements. Those who cannot afford advice or lack the knowledge and confidence to make their own investment decisions, would remain in a default arrangement whose investment process has been compromised by government intervention.

[9] 'Finishing the Job: Launching the Pensions Commission', DWP, 2025.

26. The reserve power set out in the Bill[10], were it to be used, means these risks could be realised. While we recognise that it is not the current government's preference to use the power, its' existence on the statute book until 2035 would risk future governments using DC scheme asset allocation to realise contemporary political priorities.

27. While section 28C(11) of the amended 2008 Pensions Act seeks to provide protection for scheme members by requiring the Secretary of State for Work and Pensions to prepare and publish a report on the expected impacts of using the power, we doubt whether this can really provide sufficient protection. Since projections of future impacts can only ever be illustrative and assumption-driven, it will always be possible to prepare a report that suits the agenda of the government of the day. Meanwhile, the actual impacts of using the power will be unlikely to be known until years into the future.

28. The use of the power would also bring serious accountability concerns into pension scheme governance: would any failure to deliver anticipated returns be the responsibility of the government, which mandated the allocation, or the trustees/provider that implemented it? This lack of clarity creates unnecessary and damaging ambiguity in an area that has, until now, been very clear. It risks undermining trust in the pension system.

29. In light of these risks, the best-case scenario would be for the power to be removed from the Bill altogether and we strongly recommend that the clause be deleted. Failing that, an earlier expiry date (e.g. 2030, to align with the timing of the Mansion House Accord, which the power is intended to underpin) and genuine protections for DC scheme members in the event of the power being used and poor investment outcomes resulting from it, would be welcome.

30. At a technical level there are also concerns relating to the drafting of the power:
    - There is a lack of clarity over how far the definition of default funds in the power aligns with the definition of default arrangements both in the Bill (in respect of the measures on scale) as well as other areas of pensions legislation and FCA rules.

    - While the power has been framed to cover only private assets, the wording in Section 28C(5) that excludes "securities listed on a recognised investment exchange" would appear to exclude listed closed ended funds invested in private market assets. Government should be agnostic as to the type of investment vehicle used to meet the asset allocation requirements and the Bill should reflect this. It should be for providers to determine which vehicle – open or closed-

[10] Part 2, Chapter 3, Clause 38(12) which inserts a new Section 28C into The 2008 Pensions Act.

ended – best suits their investment needs. In addition, the exclusion does not support the broader policy objective of incentivising DC master trusts or GPPs to allocate a higher proportion of their assets to private markets.

<u>Regulatory messaging on pension scheme investments and productive finance should emphasise investment in public markets too</u>

31. A broader concern with the approach in the Bill to focus on private markets is that it reflects a current political priority and distracts from what should be a more holistic view of the health of UK capital markets, both public and private.

32. It is imperative not to lose sight of the importance of pension scheme investment in public markets, which will continue to form the bedrock of scheme portfolios, and which also form the bedrock of an effective capital allocation process to channel much-needed funding to companies and the broader economy.

33. Public markets continue to provide vital funding to UK companies, contributing 48% of newly issued capital each year and accounting for 83% of all outstanding public and private capital. Outstanding capital on public equity and public debt markets sits at £5.7tn[11].

34. The market capitalisation of publicly traded companies in the UK stands at £3.5tn (including primary and secondary listings), a substantial component of outstanding public and private equity capital. Meanwhile, the total value of outstanding equity sourced from private markets remains equivalent to around 13% of the aggregate capitalisation of publicly traded companies in the UK[12].

35. A well-functioning public market directly influences the vitality of private markets. In addition to being a place to raise new capital, public markets provide critical benchmarks for valuation, liquidity, and investor sentiment, which in turn shape the environment in which private companies operate and raise capital. When public markets are stable and transparent, they offer a reliable reference point for pricing private assets, helping investors make informed decisions and encouraging capital formation across all stages of company growth.

36. Moreover, public markets serve as a natural exit pathway for private investments. The prospect of a successful IPO incentivises early-stage investment by offering a clear route to crystallising returns. This encourages innovation and entrepreneurship, as venture capital and private equity firms will be more willing to back bold ideas when they can foresee a viable exit strategy.

[11] '[UK Public and Private Capital Markets: A unified strategy for growth and prosperity]', UK Finance & EY, 2025
[12] Ibid.

37. Healthy public markets also foster a culture of governance, transparency, and regulatory compliance that can influence private companies, which may adopt higher standards of reporting and accountability as they prepare for public listings. This benefits both companies and investors and strengthens the overall market infrastructure.

38. As the Bill is debated it would be extremely helpful if the government and regulators were explicit that investment in listed asset classes also constitutes productive investment. Signalling from policymakers and regulators will be important in shaping pension scheme investment decisions. Given the on-going challenges with scaling up allocations to private market investments[13], allocations to listed assets will likely be a faster way for pension schemes to demonstrate that they are investing productively.

Retirement income

39. Where current members of FCA-regulated contract-based DC schemes typically have access to retirement products, members of trust-based schemes do not all yet have the same opportunity. This is partly because the legislative framework for trust-based schemes to develop decumulation solutions is currently incomplete but also reflects the reticence of employers to extend the scope of their pension provision (i.e. employer own-trust schemes) to include in-scheme retirement options.

40. In that regard, we welcome the government's attention in the Bill in to ensuring that members of trust-based DC schemes can benefit from retirement income solutions, rather than having to transfer their pension assets to an alternative provider. However, since the Bill by design leaves the detail of policy implementation to secondary regulations, there is a lack of clarity in the proposals, and more policy detail from the government would be helpful.

41. The Bill requires trustees and pension providers to implement 'Default pension benefit solutions'. However, as we understand the proposals in the Bill, this is not a genuine default in the sense that a customer is automatically enrolled into it, but rather a retirement solution designed by the trustees/provider which the scheme must communicate to its members, who must then choose to enter it. Given that an individual must elect to receive a retirement income and, at a minimum, provide the pension scheme with bank details in order to receive that income, we do not see how this can be a genuine default that requires no member interaction. We support the apparent recognition that a default in retirement must operate differently to a default in accumulation.

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[13] Our experience is that these allocations take time for pension schemes to make, given operational challenges around liquidity and valuation, as well as the time taken to appoint managers, along with cost constraints. These are in addition to the amount of time it takes to actually deploy capital in specific private market investments once an allocation to a manager has been made.

42. There are further areas where more clarity on the government's policy intention would be helpful. While the FCA has recently finished consulting[14] on a regime for allowing pension providers (and other financial services firms) to offer their customers Targeted Support, to help them make better decisions in relation to their retirement choices, it is not at all clear how Targeted Support would interact with the Bill proposals for default pension benefit solutions.

43. In our view, accessing retirement income should not generally be a default decision: peoples' circumstances are too heterogeneous to deliver a default retirement solution that is capable of delivering a reasonable outcome with no engagement. Every effort must be made to engage customers to help them reach a better set of decisions. If Targeted Support allows firms to direct customers to make clear decisions that result in specific product choices, it offers an important opportunity to help non-advised customers better realise the benefits of the pension freedoms.

44. We therefore welcome the recent impetus to reform the current UK regime to facilitate both better Targeted Support and simplified guidance and are highly supportive of the FCA's proposals to introduce Targeted Support for pensions, particularly in recognising the importance of providing consumers with additional support to navigate complex retirement decisions.

45. We envisage schemes first using Targeted Support to engage with members in order to help them arrive at a decision on how to access their pension wealth, with signposting to specific products as appropriate. These could be either an in-house offering or may involve partnership with an external product provider. Our preference for Targeted Support to be the first intervention reflects our view that it can put members in a better position and lead to better outcomes, by guiding them to take retirement income in a manner better suited to their particular characteristics.

46. Government should therefore primarily focus on encouraging the implementation and use of Targeted Support as far as possible, across both the trust and contract-based segments of the DC market.

47. Nonetheless, there may still be a residual group of customers that cannot be assisted in this way because they have opted out of Targeted Support[15] and chosen not to

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[14] CP25/17: Supporting consumers' pensions and investment decisions: proposals for targeted support, FCA, 2025

[15] We note that current Privacy and Electronic Communications Regulations (PECR) consent requirements hinder firms' ability to re-engage customers who have previously opted out of marketing communications, even for regulatory mandated targeted support. We support the FCA's engagement with the Department for Digital, Culture, Media & Sport to explore a narrowly tailored carve out or exemption, consistent with similar allowances in other sectors, which would enable firms to deliver essential Targeted Support reminders without undermining broader consent protections.

seek regulated advice. A solution needs to be found for this group, across both trust and contract-based schemes.

48. This is where the Bill proposal for default pension benefit solutions can play a role, as a backstop for those who opt out of Targeted Support while indicating that they want an income, without making a more specific choice as to how they access their pension.

49. This discussion highlights a second facet of the policy in the Bill where further detail is needed from the government: notably around the high-level principles of the design of the default pension benefit solutions. Recent statements from the government have focused on the need for such solutions to include a degree of longevity insurance[16].

50. If the government's intention is for individuals to receive longevity insurance through default pension benefit solutions, we doubt this is achievable: annuities are unlikely to be suitable for a default/backstop. We do not see how a decision by the provider – without customer consent – to purchase an annuity on behalf of the customer can be taken when that decision is irreversible. Default pension benefits will have to be fully flexible, so that the customer retains the ability to make an active decision in the future. Of course, this does not preclude the use of a 'flex and fix' approach to the backstop if trustees and providers are subsequently able to obtain customer consent to annuity purchase.

51. A backstop must therefore necessarily be an invested solution, at least at the outset, since this is the approach that continues to offer the customer full flexibility in the future. It must be able to deliver an income, although the customer must elect to receive an income before the backstop solution starts paying out. As set out in the Bill, it will be for trustees and providers to decide what is an appropriate design for the backstop, based on their view of the circumstances of the residual membership in it. In any case, we believe strongly that the default retirement proposals should be product neutral[17], thus allowing pension providers to deliver the solutions best suited to their membership/customer base.

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On behalf of

The Investment Association https://www.theia.org/

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[16] 'Workplace pensions: a roadmap Delivering for savers and the economy', DWP, 2025

[17] By which we mean that regulation should not incentivise the choice of one class of retirement product over another. The design of retirement income solutions should be governed by member needs.