

ACTIVE PRACTICE UPDATES

AUGUST 2023



NEW PENSION REFORMS EXPLAINED

Hunt says changes will unlock £75bn of investment.

On the evening of Monday 10 July 2023, Chancellor Jeremy Hunt delivered a speech at Mansion House in the City of London which he framed as “looking further ahead”, rather than just dealing with the immediate inflationary issues the country faces.

“I want to lay out our plans to enable our financial services sector to increase returns for pensioners, improve outcomes for investors and unlock capital for our growth businesses,” Hunt said.

These plans, or the so-called ‘Mansion House reforms’, promise to “boost returns and improve outcomes for pension fund holders while increasing funding liquidity for high-growth companies”.

Specifically, Hunt said his changes to the pension system could unlock up to £75 billion of corporate investment and boost the pension pots of retirees by 12%, equivalent to £1,000 a year.

THE NEED FOR INVESTMENT

The UK economy is more than 15 years into a period of low economic growth, underpinned by stagnant growth in labour productivity.

There are a range of contributing factors to the country’s productivity problem, but “one area of broad agreement”, as the Resolution Foundation puts it, is the country’s low investment rate.

“The UK’s low rates of business investment have persisted for many years. When combined with lacklustre investment in the public sector, the result has been a marked fall in the rate of growth of capital per person or per employee,” the think tank wrote.

Business investment is lower in the UK than any other country in the G7, and 27th out of 30 OECD countries, ahead of only Poland, Luxembourg and Greece.

Hunt seemed to recognise the problem at Mansion House. “Currently we have a perverse situation in which UK institutional investors are not investing as much in UK high-growth companies as their international counterparts,” he said.

PENSION REFORMS

Hunt’s announcements on pensions came with five reforms. Some consultations will be necessary to hammer them out, but all final decisions will be made ahead of the Autumn Statement later this year, Hunt said.

The Mansion House Reforms will be guided by the Chancellor’s three golden rules: to secure the best possible outcome for pension savers; to always prioritise a strong and diversified gilt market as the Government seeks to deliver an evolutionary, rather than revolutionary, change in the pensions market; and to strengthen the UK’s position as a leading financial centre to create wealth and fund public services.

First, CEOs of the largest defined contribution pension schemes, including Aviva, Nest and Aegon, have signed a ‘Mansion House Compact’ committing them to allocating at least 5% of their default funds to unlisted equities by 2030.

The UK currently invests under 1% of funds in unlisted equity, compared to between 5% and 6% in Australia.

"If the rest of the UK's defined contribution market follows suit, this could unlock up to £50bn of investment into high growth companies" by the end of the decade, Hunt said.

Second, the Government will "facilitate" a programme of defined contribution consolidation "to ensure that funds are able to maintain a diverse portfolio of bonds, equity and unlisted assets and deliver the best possible returns for savers".

As such, pension schemes that are not achieving the "best possible outcome for their members" will face being wound up by the Pensions Regulator.

Mel Stride, secretary of state for work and pensions, explained the decision, saying: "Analysis shows that over a five-year period there can be as much as 46% difference between the best and worst performing pension schemes.

"This means that a saver with a pot of £10,000 could have notionally lost £5,000 over a five-year period from being in a lowest performing scheme."

Third, ahead of the Autumn Statement, the Government will explore whether it can establish investment vehicles via the British Business Bank.

Hunt said: "Ahead of the Autumn Statement, we will test options to open those investment opportunities in high-growth companies to pension funds as a way of crowding in more investment."

Fourth, Hunt moved on to defined benefit schemes, which number over 5,000 and operate under a different regulatory regime, announcing a "permanent superfund regulatory regime" to provide a "scaled-up way of managing defined benefit liabilities".

Finally, the Government will open a consultation on doubling existing investments held by local Government pension schemes (LGPS) in private equity to 10%, which could unlock £25bn by 2030.

The consultation proposes a deadline of March 2025 for all LGPS funds to transfer their assets into pools and that each pool should hold more than £50bn of assets.

Hunt said: "Today's announcements could have a real and significant impact on people across the country.

"For an average earner who starts saving at 18, these measures could increase the size of their pension pot by 12% over their career – that's worth over £1,000 more a year in retirement.

"At the same time, this package has the potential to unlock an additional £75bn of financing for growth by 2030, finally addressing the shortage of scale up capital holding back so many of our most promising companies."

PROPOSALS WELCOMED BY SOME EXPERTS

Dr Yvonne Braun, director of policy, long-term savings, health, and protection at the Association of British Insurers welcomed the Mansion House reforms, saying: "We want to see successful, enduring pensions policies that help deliver better returns for savers as well as boosting the UK economy, and we fully support the Government's ambition to achieve this."

Director general of the British Chambers of Commerce, Shevaun Haviland, also broadly supported the Mansion House Reforms, commenting: "Boosting investment is key to remaining globally competitive, increasing economic growth and strengthening UK capital markets.

"Challenges around public investments, such as HS2, illustrate the importance of leveraging more private sector investment into UK infrastructure projects, which can complement the UK's already strong track record in encouraging private investment into infrastructure such as maritime ports, water supply and airports."

However, she added that the Government should not neglect channelling investment into local economies and supply chains.

"With SMEs accounting for 80% of the UK's economy, these businesses must also benefit from easier access to capital funding," she said.

THE 'URGENT' NEED FOR A ROADMAP

Something that was noticeably missing from Hunt's speech and the Government's follow up publications was a roadmap for the Mansion House pension reform package. That fact prompted pensions and financial company Aegon to call for one to avoid "mind boggling complexity and chaos".

Just like many in the pensions industry, Aegon also welcomed the reforms, describing it as "all guns blazing". However, Steven Cameron, pensions director at Aegon, warned that: "charging ahead without a well thought-through overarching plan could lead to chaos".

"Pensions are some of the longest-term investments individuals make, and while government, regulators and industry should always be looking for improvements, a mad rush to implement too much, too soon without a full understanding of the consequences could be highly risky."

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