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Policy Paper

from MoneyShe

Leveraging Pension Funds to Stimulate UK Investment and Economic Growth

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Executive Summary

The United Kingdom's economic vitality is intricately linked to robust investment in infrastructure, innovation, and domestic enterprises.

Pension funds (Define Benefit, Define Contribution and Local Government Pensions Schemes, with assets totalling approximately £3 trillion[1], represent a significant reservoir of capital that, if strategically mobilised, can substantially contribute to national growth objectives.

Successive Governments since 2010 have talked about unlocking this fiscal reservoir, but little has been done in the UK whilst other countries – Australia, Canada and Nordic countries in particular – have acted and seen both their economies and the pension fund beneficiaries significantly benefit.

This policy paper outlines a comprehensive strategy for the Government to harness pension fund assets to boost investment and economic expansion, drawing on successful international models and addressing potential challenges.

1. Introduction

The UK's pension landscape comprises a diverse array of schemes, including defined benefit (DB) and defined contribution (DC) plans, as well as local Government pension schemes (LGPS).

Historically, these funds have exhibited a conservative investment approach, with a notable decline in allocations to UK equities - from 53% to just 6%[2] over the past two decades.

This trend underscores a pressing need to reassess and realign pension fund investment strategies to better support domestic economic priorities.

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

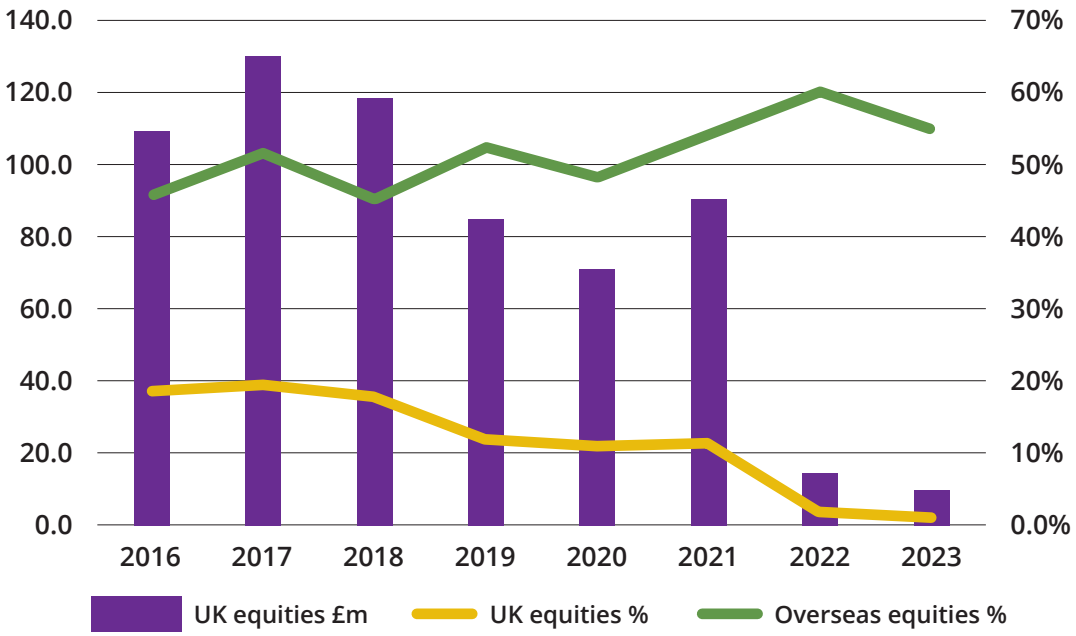
[2] https://capitalmarketsindustrytaskforce.com/wp-content/uploads/2023/03/2023.03-Unlocking-the-capital-in-capital-markets-New-Financial.pdf

MPs' Own Pensions – Lead By Example

At its peak, the MPs' pension fund (the Parliamentary Contributory Pension Fund - PCPF) held £130m in UK equities. At the last year-end, this had reduced by 92% to only £10m[3].

This represents a 1.3% weighting to UK equities[4] of the total funds and 2.3% of the equity portfolio. This means it is materially underweight vs the UK's share of global equities (3.5% according to MSCI[5]). Most voters would be astounded that their MPs pensions are supporting overseas companies rather than growing UK companies.

PCPF allocation to UK equities



Source: PCPF annual reports

[3] https://www.mypcpfpension.co.uk/wp-content/uploads/2023/12/PCPF-Accounts-2022-2023-published-online.pdf

[4] https://www.peelhunt.com/news-insights/articles/pensions-labour-manifesto-plus-mps-scheme

[5] https://www.msci.com/documents/10199/178e6643-6ae6-47b9-82be-e1fc565ededb

Overall, the fund has moved from a 65% weighting in equities in 2016 to 56% in 2023, but the overall weighting to global equities has increased materially over the period.

The MPs' fund is in an accounting surplus and was valued at £780m at the end of March 2023. If the fund moved to a say a 10% weighting in UK companies, it would increase the holdings by £68m.

Comparatively, Australian superannuation funds maintain a higher allocation to domestic equities. As of June 2024, these funds allocated approximately 44%[6] of their portfolios to Australian equities. If the Parliamentary Contributory Pension Fund were to align with this approach and allocate 23% of its assets to UK equities, this strategy would increase the fund's UK equity holdings by £169.4 million.

Canada – Maple 8

Even though Canadian pension funds are seen as the model to follow in terms of investing in domestic equities, in March 2024, a letter signed by 90 executives[7] of Canadian companies called for Canadian funds to make more investments domestically.

In April 2024, Stephen Poloz, a former Bank of Canada governor[8], was appointed as the head of a federal working group that will examine how the Canadian Government could encourage domestic investing from the country's pension funds.

2. Policy Objectives

The primary objectives of this policy initiative are to:

- Mobilise Pension Capital for Domestic Growth: Encourage pension funds to increase investments in UK infrastructure, startups, and growth-oriented enterprises.

- Enhance Pension Fund Returns: Diversify investment portfolios to include high-growth assets, potentially improving returns for pension beneficiaries.

- Strengthen Economic Resilience: Reduce reliance on foreign investment by bolstering domestic funding sources for key economic sectors.

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[6] https://www.ssga.com/library-content/assets/pdf/apac/insights/2024/home-bias-in-australian-equity-allocations.pdf

[7] https://www.lba.ca/publication/open-letter-canada/

[8] https://www.osler.com/en/about-us/media-centre/stephen-poloz-appointed-to-head-working-group-on-pension-investments

3. Strategic Framework

To achieve these objectives, the following strategies are proposed:

3.1. Consolidation of Pension Schemes

Fragmentation within the UK pension system has been identified as a barrier to efficient capital deployment.

Consolidating smaller pension schemes into larger “megafunds” can enhance investment capacity and risk management.

This approach draws inspiration from the Canadian model, where pooled pension funds have successfully undertaken substantial investments in national infrastructure and innovation.

The Government’s plan to merge local Government pension scheme assets aligns with this strategy, aiming to create funds with the scale necessary for impactful investments.

3.2. Incentivising Investment in UK Assets

To redirect capital towards domestic opportunities, the Government can implement incentives for pension funds that allocate a significant portion of their portfolios to UK infrastructure projects, private equity, and venture capital.

This may include tax benefits, co-investment opportunities, or adjustments to regulatory frameworks to facilitate such investments. For instance, defined contribution schemes, which are poised for growth, could be encouraged to invest in high-growth assets, thereby supporting startups and infrastructure development.

3.3. Regulatory Reforms

Reviewing and amending existing regulations can remove obstacles that deter pension funds from investing in domestic growth sectors.

This includes revisiting guidelines that currently discourage higher-risk investments, thereby enabling funds to pursue opportunities that offer potentially higher returns and contribute to economic development. Ensuring fiduciary duties are balanced with national investment objectives is crucial in this context.

4. Addressing Potential Challenges

While the proposed strategies offer a pathway to enhanced investment and growth, several challenges must be acknowledged and addressed:

- Fiduciary Responsibilities: Pension fund trustees are legally obligated to act in the best financial interests of beneficiaries. Policies must ensure that encouraging domestic investments does not compromise returns or increase undue risk.

- Market Liquidity and Risk: Investments in infrastructure and startups may lack liquidity and carry higher risk. Developing mechanisms to manage these factors, such as creating secondary markets or offering Government-backed guarantees, can mitigate potential downsides.

- Global Diversification: While focusing on domestic investments, maintaining a diversified portfolio is essential to manage risk effectively. Lessons from Canadian pension funds highlight the importance of balancing home-country investments with international diversification to optimise returns and minimise exposure to local economic fluctuations.

5. Conclusion

By strategically leveraging the substantial assets held within UK pension funds, the Government can stimulate significant investment in critical sectors, fostering economic growth and resilience.

Through consolidation, targeted incentives, enhanced expertise, and thoughtful regulatory reforms, pension funds can be transformed into powerful catalysts for national development, benefiting both the economy and pension beneficiaries.

6. Recommendations

- Initiate a Comprehensive Review: Conduct an in-depth analysis of existing pension fund structures and investment patterns to identify consolidation opportunities and barriers to domestic investment.

- Develop Incentive Programs: Design and implement incentives that encourage pension funds to allocate a greater share of their portfolios to UK-based assets, ensuring these incentives align with fiduciary duties.

- Pursue Regulatory Reforms: Amend regulations to facilitate and encourage pension fund investments in domestic growth sectors, while safeguarding the interests of beneficiaries.

By adopting these recommendations, the Government can effectively mobilise pension fund capital to drive sustainable economic growth and prosperity across the United Kingdom.

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