DWP DC Policy Team
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By email: quarryhouse.pensionsinvestmentreviewdcreforms@dwp.gov.uk

16 January 2025

Dear DC Policy Team,

**Re: Pensions Investment Review: Unlocking the UK pensions market for growth**

The BVCA is the industry body and public policy advocate for the private equity and venture capital (private capital) industry in the UK. With a membership of over 600 firms, we represent the vast majority of all UK-based private capital firms, as well as their professional advisers and investors. In 2023, £20.1bn was invested by private capital into UK businesses in sectors across the UK economy, ranging from consumer products to emerging technology. There are over 12,000 UK companies backed by private capital which currently employ over 2.2 million people in the UK. Over 55% of the businesses backed are outside of London and 90% of the businesses receiving investment are small and medium-sized businesses.

We welcome the opportunity to provide feedback on the Call for Evidence as part of the Government's Pensions Investment Review. We have separately submitted our views on the proposals relating to the Local Government Pension Scheme and would welcome the opportunity to discuss both. Please do not hesitate to get in touch if you have any questions or if you would like to discuss any of the above in more detail (please contact Tom Taylor ttaylor@bvca.co.uk / Karen Hurst khurst@bvca.co.uk).

**Executive Summary**

- The BVCA welcomes the Government's proposals to limit the number of default strategies per provider and to set a minimum AUM per strategy. Scale is a necessary pre-requisite to pension funds' ability to invest in private capital, providing them with the expertise and resource to fully diversify. Without intervention, it does not seem likely that many of the UK's DC providers will reach such a threshold. We do not see that the continued fragmentation of the landscape is working in the interests of DC savers.
- Further consideration should be given to ensuring that DC schemes can support smaller, regional funds as they become more equipped to invest in private capital. These funds play a significant role in growing successful businesses, though are usually restricted in the size of investments. Strong governance and well-resourced investment teams can help funds invest in these opportunities, and the Government should consider how best to ensure these conditions are in place.
- The Government should ensure that the necessary resources and guidance are in place to ensure that providers can efficiently transition and achieve scale. This means regulators being able to quickly process permissions, and ensuring guidance is in place to address any unresolved questions.

- Rules around cost disclosure continue to impact DC providers' confidence in investment in private markets. Consideration should be given to providing more clarity and certainty to ensure trustees have the assurances they need around address cost.
- The BVCA welcomes the proposal to allow the bulk transfer of FCA regulated pension providers, as is currently the case in the trust-based market. This is important in ensuring that the Value for Money framework applies across the DC pensions landscape.
- Implementing an effective 'Value for Money' framework is essential if DC providers are to feel they can make long term investment decisions in the interests of savers. The DWP and the FCA need to progress with the framework urgently, and to ensure that consideration is given to the interaction between these proposals, and those already consulted on in relation to the framework. It is also important that the framework does not penalise long-term, private capital investments.
- We are pleased to see the consultation does not include any mandatory UK allocation requirement, and hope that this will continue to be the approach as the Government progresses with its pensions review.

## Introduction

The BVCA welcomes the clear commitment from the UK Government to achieving increased investment from UK pension funds into private capital through the creation of DC 'megafunds'. The Pensions Investment Review and associated Pension Bill are encouraging steps in the right direction.

We feel there is real urgency to the matter. The UK is lagging in comparison to its international counterparts. Over 85% of capital raised by private capital funds in 2023 came from overseas investors (£51bn out of £59bn). This rises to 97% when looking at fundraising from pension schemes (£16.2bn out of £16.7bn). Put another way, only 3% of the total pension funding committed to UK managed private capital funds in 2023 came from UK pension funds, despite the industry's long track record of producing strong returns for investors. Given the evidence clearly showing that 50% of savers will meet the retirement income standards set by the 2005 Pensions Commission[1], we believe there needs to be change.

The BVCA has seen growing interest in private capital from increasing numbers of UK pension schemes, and private capital firms engaging on the matter: 11 of the largest pension providers signaled their ambition to allocate £50bn of their default capital to unlisted equities by 2030 as part of the Mansion House Compact in 2023, and over 100 private capital firms signed the Investment Compact for Venture Capital and Growth Equity[2] the same year. However, as of July 2024, signatories to the Mansion House Compact held the equivalent of 0.36% of the total value of their DC default funds in unlisted equity assets (£793m of £219bn)[3]. So, moving quickly from consultation to concrete proposals and implementation will be key.

[1] https://www.plsa.co.uk/Policy-and-Research/Topics/Improving-pensions-adequacy
[2] https://www.bvca.co.uk/static/805ec0a9-7a93-4f6c-a970f61495658b6b/240205-Investment-Compact-final-tranche.pdf
[3] https://www.abi.org.uk/globalassets/files/publications/public/lts/2024/abi-mansion-house-compact.pdf

Together with the pensions industry, the BVCA convened the Pensions & Private Capital Expert Panel to find solutions to technical, market and policy challenges that currently limit pension scheme investment into private capital funds. The Expert Panel published its Interim Report in September 2024, available here.

The full interim recommendations are as follows:

1. The DC pensions industry should be empowered by government and regulators to move away from short-term cost considerations to long-term returns.
2. Consistent cost disclosure requirements must be applied across the investment ecosystem.
3. The private capital and pensions industries should work together to develop a model Request for Proposal.
4. DC schemes, platforms and advisers should use quarterly private capital valuations, alongside appropriate governance for unusual liquidity events, as a means of ensuring fairness between members in unit pricing.
5. All parties should consider how far new and alternative approaches to fee structures might be made to work in savers' interests.
6. As the Government explores the creation of a new investment scheme vehicle, it should draw on existing initiatives, particularly on overseas examples, including the French Tibi Scheme.
7. The FCA should review the relevant regulations and processes to encourage more LTAFs to come to market.
8. The FCA should review and amend the Permitted Links rules.
9. Life platform providers must offer private capital options for DC schemes.
10. Regulators should work with industry to provide reassurance and updated guidance on their liquidity expectations for how DC schemes should handle stress events and their impact on liquidity.
11. DC schemes should consider the role of "to and through" investing, with a view to keeping savers invested in private capital investments for longer periods of time.
12. Industry and Government work together to determine how risk can be better pooled in DC structures, in the interest of savers. In particular, CDC schemes should continue to be explored.

In addition, the BVCA has strongly supported the Government acting to ensure that DC schemes have the scale to enable members to benefit from private capital investments. This was highlighted in both our response to the Pensions Investment Review Call for Evidence, and our manifesto published before the 2024 General Election.

Below we have responded to a number of the consultation questions with further detail.

**Question 1: Do you think that providers should be restricted to a limited number of default funds, and if not why? Please consider any equality considerations, conditions and to what extent saver choice could be impacted.**

The BVCA supports this measure, as we believe that scale is the minimum condition needed for pension funds to be able to invest in private capital. As is outlined in the consultation document, this is demonstrated in evidence from other nations, where countries with larger, more consolidated DC provision see significantly larger sums invested in private capital and other illiquid options. Scale enables the right expertise, contacts and the ability to develop in-house capabilities.

As the consultation document outlines, though consolidation is already happening, it is concentrated in the smaller end of the market. We do not take the view that sufficient consolidation is likely to happen at the speed needed to achieve the Government's ambition, or that of the Mansion House Compact, without intervention. Given the relatively conservative levels of returns and low engagement in DC pensions, the BVCA does not consider that the complexity of the existing DC landscape is best serving savers, and is denying many the benefits of scale in their pension pots. That lack of scale makes it difficult for savers to engage in their pensions and stifles any competition in the market that might drive up demand for alternative, more returns-focused investment strategies.

We therefore support the proposal based on the Australian model, that there should be a limited number of default strategies per provider. Alternatives to the default would be clearly classified as self-select, for example, to offer Sharia compliant options and to reflect individual investment beliefs.

We should stress that we do not think that scale is the only factor in whether pension providers can and will invest in private capital. The Government should give further consideration to how larger DC schemes can support growth throughout the UK through smaller, more diversified investments. Nevertheless, we do think scale is a pre-requisite for diversification into private capital and therefore support the proposal.

**Question 2: The proposed approach at default fund level could mean that the number of default arrangements would remain unchanged. Will imposing the requirement at this level have any impacts on the diversity of investments or the pricing offered to employers?**

We support the requirements on a single default being implemented at the default strategy i.e. the level that assets are pooled at. We are supportive of the proposal from the PLSA on how this should be interpreted. This will enable the pooling of funds across different products and employers, leading to greater scale, with the attendant benefits for private capital investment noted above. We note the lack of agreement on the language across the landscape which makes it paramount that the regulations are absolutely clear as to what the requirements are. We understand that target date funds often have different funds within the same arrangement to reflect different stages, but which are ultimately all within the same default strategy. The regulations would need to set consistent expectations that did not enable regulatory arbitrage, which could undermine their implementation.

**Question 3: What do you think is the appropriate minimum size of AUM at default fund level within MTs/GPPs for these schemes to achieve better outcomes for members and maximise investment opportunities in productive assets?**

The BVCA supports plans to set a minimum size of AUM. If the Government wants to increase returns for savers and back UK businesses, the number of DC schemes in the UK needs to be reduced. There are currently more than 28,000 DC schemes in the UK, with three quarters of assets sitting in 36 Master Trusts. While some Master Trusts are already consolidating, they are not currently achieving the scale needed to realise the Government's ambitions in this area. The commercial nature of the DC market means savers' interests are served by competition between providers, but 36 MTs is still too many.

The minimum size threshold to achieve this should be informed by existing market experience. Nest has begun to make private capital investments with a scale of around £50bn and a forecast to pass £100bn assets under management (AUM) by 2030. This would be consistent with the experience of Canadian pension schemes, which report realising significant benefits of this scale at an estimated Can$80bn, or £44bn at current exchange rate. Data from CEM suggests pension schemes of around £20bn typically invest 20% in private markets. We therefore agree with the Government's assessment that a minimum threshold set in the rules within the range of £25bn-£50bn would accurately reflect when the benefits of scale, in terms of substantial private markets investment, can start being realised.

**Question 5: Do you think there should be targets for (i) achieving a reduction in default fund numbers down to a single fund and, (ii) setting incremental minimum AUM?**

We agree that this seems sensible and proportionate. In our response to the Call for Evidence in September 2024 we called for a Government roadmap towards consolidation – we recognise that altering the landscape will require Government and pension providers to work in partnership. This is important to ensure that the changes can happen efficiently and quickly.

**Question 6: Are there any potential barriers/challenges that should be considered in reaching a minimum size of AUM at default fund level before a future date, such as 2030?**

We recognise that there is likely to be a number of practical considerations for schemes and would urge the Government to ensure that it is able to support them with these. For example, regulators should ensure that they are sufficiently resourced to provide the regulatory permissions within the desired timeframes. We understand that, at the moment, this is not always the case.

In addition, we believe that the Government will need to provide direction on how schemes can overcome practical challenges this is likely to present, such as how to standardise the terms and conditions for all members of a newly merged default fund. Leaving those sorts of questions to the market risks further delay, so Government needs to be fully prepared to support the transition.

Consideration also needs to be given to ensuring that the transition to fewer schemes does not result in an increased focus on low-cost options and subsequently drives down investment in more productive assets. It is essential the Government progresses with the Value for Money proposals which, alongside scale, will be vital in enabling DC schemes to invest in a wider range of assets. It is also important that the framework does not penalise investments made with a view to prioritising returns over the long-term. The proposals consulted on by the FCA in 2024 appear to require IGC's to consider and act against short term metrics. The BVCA does not agree that this will provide pension schemes with the comfort needed to invest for the long term, and so would urge the DWP/TPR and the FCA to give further consideration to the design of the framework.

**Question 7: Given the above examples, what exclusions, if any, from a required minimum size of AUM at default fund level and/or the maximum number of default funds requirement should government consider?**

A small number of schemes have hybrid DB-DC arrangements, which do not neatly fit into these requirements. We do not take the view that schemes offering DC in addition to DB arrangements is detrimental to members and so believe that an exemption would be justified.

**Question 8: With regards to the proposals in this chapter, we anticipate the need for mechanisms to encourage innovation and competition, and for safeguards to protect against systemic risk. Are there other key risks that we need to consider? How do we mitigate against them?**

Though we recognise that the landscapes are very different, the debate as regards the LGPS about minimum investment levels is relevant to this discussion, as DC moves towards larger pools of capital.

Consolidated UK pension schemes will need to be able to make fund commitments of £10-50m if the Government wants them to invest in the smaller, often regional segments of the UK economy where local economies, growth and jobs are supported by smaller private capital funds.

In general, investors will typically not invest in any private capital fund if their capital would constitute more than around 10% of the fund's total capital, alongside other investors, due to the possibility of concentration risk. The optimal size of smaller private capital funds (which is based on the size of the smaller companies they invest in) is typically around £100-500m. This means that the maximum commitment any single investor will make is typically around £10-50m (known as the fund's maximum "ticket size").

It is critical for the Government to give determined, specific policy consideration to how a consolidated £25bn+ DC pension scheme can make individual investments of £10-50m. There is a powerful efficiency rationale, as an investor grows in size, for its minimum ticket size to increase. This is because large pools of capital need to deploy large amounts of capital, and it can seem inefficient for larger pools to make lots of smaller investments (rather than fewer, larger investments). This can lead to the investor's self-defined minimum ticket size exceeding the maximum ticket size of smaller private capital funds.

Allowing this rationale favouring large ticket sizes to prevail unchecked as UK pensions are consolidated would be a mistake and would undermine its aims to boost both UK pension returns and UK economic growth. We suggest that the solutions to this challenge lie in ensuring strong governance and sufficient investment budgets. The aim of the proposals should be diversification, rather than cutting costs. The BVCA would welcome further consideration of how the regulations will enable this.

**Question 9: Under a minimum AUM model, competition in the market could be more restricted. Would additional exceptions be required to ensure innovation can continue to flourish?**

The BVCA does not agree with this assessment. There is strong reason to believe that, in a less fragmented market, there is potential for more vibrant competition than is currently the case. We do not agree that consumer interests are currently being well served by this fragmentation. Larger DC schemes will be better equipped to innovate, and to drive competition between providers.

As set out in our response to Question 8, further consideration should be given to what conditions can be put in place to best enable funds to invest in a wide variety of smaller opportunities, in order to diversify returns and to support regional UK growth.

**Question 10: We would welcome views on what further interventions or regulatory changes might be necessary or beneficial to accelerate this process?**

Though there have been significant changes to the DC charge cap in recent years to better enabled DC schemes to invest in private capital, we would also flag the findings of the Pensions & Private Capital Expert Panel, which noted that cost disclosure continued to be an area of uncertainty that is impacting DC schemes' confident in private capital investing. The Panel noted, for example, that there continues to be uncertainty over how the charge cap should be applied, and how to apply 'look through' in more complex fund-of-fund structures. This results in DC trustees needing to make a judgement on how to consider costs and charges and results in them erring on the side of caution and restricting which investments can be included in default arrangements.

This won't be addressed by scale and so we would welcome further consideration of whether the cost disclosure requirements are clear and proportionate in DC.

**Question 11: How would moving to a single price for the same default impact positively or negatively on employers, members and providers?**

It's not clear whether price in this question refers to investment costs or the whole bundled cost to members.

However, we understand that differential pricing for the non-investment elements can cover a number of factors, including the size of the employer and the scheme accommodating different employer-specific needs. This is not necessarily a bad thing, and it reflects the benefits of scale and encourages employer engagement. A new requirement to charge the average in terms of administrative fees would have wider repercussions that would need to be considered – for example, whether this would reduce competition between providers because some would target certain types of employer in order to keep administration costs low.

Given the wider debate around cost and value, and the importance of getting this right, we strongly encourage further detailed consideration of such a proposal before it is implemented.

**Question 12: Under what circumstances should providers be able to transfer savers to a new arrangement without their consent?**

As set out in the BVCA's response to FCA Consultation on Value for Money in October 2024, we are supportive of legislative changes that would enable the FCA to override contract-based arrangements where it is satisfied that they are not serving members' best interests. Unless such legislation is implemented, then the Value for Money framework risks being meaningless for the GPP market.

As is set out in the consultation, there are a number of circumstances where an over-ride of action could be the most appropriate, mostly notably when an arrangement has been assessed as 'Red' as part of the Value for Money assessment, or where it has been established that providers would not be compliant with Consumer Duty expectations unless they act.

We are not of the view that the rules should provide an exhaustive list of circumstances when an override may occur. Instead, the rules must ensure that the guidance and governance requirements are sufficient to ensure that instances of poor value can be identified.

**Question 13: Do you think that an independent expert, such as an IGC, should be responsible for undertaking the assessment of whether a transfer is appropriate?**

Overall, we believe that this is consistent with the Value for Money proposals, which would require the IGC to make an assessment of value.

We believe that the implementation of an effective Value for Money framework is essential in moving away from the low-cost culture in DC, and therefore that the interaction between these proposals, and the VfM framework is considered fully.

**Question 14: What, if any, changes may be needed to the way an IGC's role, or their responsibilities/powers for them to assess and approve contractual overrides and bulk transfers?**

In our response to the FCA Value for Money proposals, we noted a concern that the requirements on how IGC's should undertake a value assessment were quite prescriptive, and that this may force them to penalise schemes that were reasonably invested for the long term, but which were not comparable with peers with regards to short-term performance.

Both the Value for Money proposals and this consultation potentially create a greatly enhanced role for IGCs, and so it is reasonable to consider whether they have the right expertise and independence, and that they receive independent actuarial advice on the long-term position of savers within a scheme, relative to alternative options in the market.

In principal, however, we agree that the IGC is an appropriate body to undertake this task.

**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?**

The BVCA supports a more engaged role for employers, given the important role they play in both selecting the pension arrangements for savers, and also in dictating the wider market conditions in workplace pensions. It is important that they give full consideration to the performance of a pension arrangement, rather than the existing focus on cost. Given the introduction of the Value for Money framework, it is appropriate that further responsibilities are considered for employers and both the proposals in Questions 29 and 30 have merit.

That said, we are mindful that there are likely to be limitations on how far employers feel able to engage in these complex matters – particularly smaller employers that do not have sufficient resources. The Government should therefore focus on proposals to improve the standards of DC workplace pensions, and of the professional advice provided, and to encourage more healthy competition in the landscape.

**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?**

**AND**

**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?**

We welcome both these proposals, given the clear role that investment consultants and Employee Benefit Consultants play in the application of Auto-Enrolment. Given that the introduction of any regulation would be happening alongside the implementation of the Value for Money framework, it is important that the rules embed the framework within the advice given to employers and schemes, to ensure that long term value is the focus of advice.

Mandatory UK allocations

Though this is not specifically explored in the consultation, we understand that the case for UK mandation may be explored in a future phase of the Pensions Review. Though we welcome initiatives designed to encourage and enable investment in both the UK and its regions, some of which we have outlined above, mandatory requirements risk de-prioritising scheme members' interests, denting scheme performance, distorting the market and creating asset bubbles. It is important that this is factored into the Government's consideration of the future direction of these reforms.

Please do not hesitate to get in touch if you have any questions or if you would like to discuss any of the above in more detail (please contact Tom Taylor ttaylor@bvca.co.uk / Karen Hurst khurst@bvca.co.uk).

Yours sincerely

Tom Taylor,

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