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HM Treasury
1 Horse Guards Rd
London
SW1A 2HQ

Submitted via email to: quarryhouse.pensionsinvestmentreviewdcreforms@DWP.GOV.UK

RE: Pensions Investment Review: Unlocking the UK pensions market for growth

BlackRock[1] is pleased to have the opportunity to respond to the Department of Work and Pensions (the '**DWP**') and HM Treasury ('**HMT**') joint consultation on Unlocking the UK pensions market for growth.

BlackRock's purpose is to help more and more people experience financial well-being and we manage the savings of over 13 million people in the UK. As a fiduciary to investors and a leading provider of financial technology, we help millions of people build savings that serve them throughout their lives by making investing easier and more affordable.

We welcome the opportunity to comment on the issues raised by this consultation paper and will continue to contribute to the thinking of the Government on this and other topics.

Yours faithfully,

Gavin Lewis
Managing Director
Head of UK and Ireland Institutional
gavin.lewis@blackrock.com

Muirinn O'Neill
Director
Government Affairs & Public Policy
muirinn.oneill@blackrock.com

Tim Hodgson
Managing Director
Head of UK DC Platforms & Retirement Solutions
tim.hodgson@blackrock.com

[1] BlackRock is a leading provider of investment, advisory and risk management solutions, and has been active in the UK for over 50 years.

Executive Summary

There are clear benefits linked to scale. It tends to be linked to more resources dedicated to governance, stronger negotiation power over fees, and greater investment expertise. As one of the largest managers of DC assets in the UK, we have observed a marked professionalisation of the DC segment in recent years as the market has consolidated and we see this as an overwhelmingly positive trend for member outcomes.

However, while there are undoubtedly many benefits to scale, we would stress that scale is not the sole determinant of scheme quality. In our view, factors like governance and investment oversight are key drivers of delivering improved long-term risk-adjusted returns and capacity to invest in a wider range of asset classes. Insofar as scale allows further resource to be dedicated to these functions, we believe that members will see improved outcomes.

The consultation proposals provide a foundation for greater scale but do not, in and of themselves, provide a roadmap to the creation of such investment governance and implementation frameworks. In our view, policy should focus on ensuring that pension schemes put these frameworks in place and that they function effectively on an on-going basis. This is more important to delivering investment outcomes to scheme members than focusing narrowly on the achievement of a specific minimum threshold for scale.

This does not preclude the possibility of the Government and regulators setting an expectation of the requisite scale it wishes to see and then relying on regulatory supervision by the FCA and TPR to ensure that schemes are broadly in line with or above this level. However, the focus should always be on ensuring that schemes are set up to deliver the best investment outcomes.

As highlighted in our response to the previous Pensions Investment Review consultation, we see the intense price competition which exists in the DC market as one of the key barriers to investment in a wider class of assets. We are very supportive of the Value for Money (VfM) framework and believe that careful consideration is needed regarding the interaction between these proposals and VfM, to ensure these changes do not entrench further price competition and encourage herding in investment strategies.

Achieving scale in the Defined Contribution market

Default arrangement vs default fund

We suggest that any AUM targets should be at arrangement level – that is the level at which asset allocation is decided, and this can pool funds from different products and employer arrangements. We would not support the targets being applied at the level of the underlying pooled funds.

DC investment strategies are generally constructed using multiple pooled vehicles as building blocks that together form the desired investment strategy, with appropriate risk and return characteristics. It is common industry practice for many of these strategies to invest in underlying pooled vehicles in a Fund-of-Funds structure. It is often the case that these underlying building blocks are large funds, aggregating the investments of a broad pool of investors beyond just the UK DC market, and bringing the benefits of scale and professional investment management to all investors in the fund.

Maximum defaults

We understand the impetus in the consultation to simplify the number of defaults a firm runs, however, many providers have a few different defaults to cater for different price points and investment strategies, according to employer choice.

For example, some providers offer 'premium' defaults, these typically invest more in private markets and are therefore more expensive; we would see it as a bad outcome for savers and counterproductive to the Government's wider agenda if these strategies were unable to continue. Comparisons with Australian Supers are unhelpful here, Australia does not have the same fee compression we experience in the UK, hence there is no need for a more premium option.

In our view, providers should be allowed a small number of 'firm-designed' defaults to allow for preferences around sustainability, religious beliefs, demographics, and cost.

Minimum AUM

While we agree with the points made in the consultation regarding some of the benefits of scale, we would stress that scale is not the sole determinant of scheme quality. In our view as a global asset manager working with large asset owners in different jurisdictions, we see governance and resource dedicated to investment oversight as key drivers of delivering improved long-term risk-adjusted returns and capacity to invest in a wider range of asset classes.

We would thus suggest that a narrow focus on meeting a minimum scale threshold may not drive the outcomes that Government wants to see and that are in the long-term interest of members. In our view, policy should focus on ensuring that pension schemes are set up to deliver the best investment outcomes. Government could consider taking an approach whereby a scheme is authorised to operate based on a plan which would include growth intentions and innovation plans. This would enable the decision to be made on a more holistic basis, where factors other than scale could be taken into account.

This does not preclude the Government setting an expectation or target of the scale it wishes to see, but prevents the cliff edge created by setting out a minimum AUM figure in regulation.

Encouraging innovation

As the consultation document notes, one concern we have around the introduction of a minimum scale threshold is that it may prevent challenger firms entering the market, or may force smaller players out of market who are offering something new and innovative. We would see it as a negative saver outcome if smaller schemes that are offering good VfM and innovative investment strategies were forced out of market by this change.

Similarly, the consultation rightly recognises multi-employer CDC as an important and exciting growth area, if the Government wants to encourage new innovation and promote competition, then exceptions to the minimum AUM will be critical. This tension further underlines our suggestion around a more principles-based approach, which allows firms to outline their growth and innovation plans.

Finally, careful consideration is needed on the interaction between any minimum AUM threshold and the new VfM framework. In a much more consolidated market, there is even more potential for herding in DC investment strategies, given that the consequences of an Amber or Red rating would be further amplified.

Contractual override

We are supportive of the principle of transfers out of contract-based schemes without member consent when it is in the interest of customers. The proposals for a contractual override to enable providers to move members into better products without consent would be a positive move, providing the governance around the process is rigorous.

Cost versus Value

The role of employers and advisers

We do not support a duty being placed on employers, including a named executive with responsibility of retirement outcomes, due to the burden this would place on small employers. However, we do see a need for further guidance for employers to help them with their decision making.

The current TPR guidance only refers to costs and how they are structured, the type of tax relief used by the scheme, additional services offered by the Master Trust or provider, such as writing to members, and whether it fits with the payroll systems they use. This does not give sufficient support to employers who are unfamiliar with the pension landscape and will not drive the outcomes the Government is looking to see in this segment.

In terms of advisers, as we stated in our previous response, given the role of Employee Benefit Consultants (EBCs) in helping employers to choose a suitable pension scheme for their employees, for the VfM framework to be successful there is a need to ensure consultants take it into account when advising employers through some form of duty or industry commitment.