Rachel Reeves' pension reforms labelled 'not radical enough' by City experts

Chancellor Rachel Reeves used the term "radical" to describe her plans for a comprehensive reform of the UK's disjointed pension sector, which she unveiled last night.

In her inaugural Mansion House speech tonight, she will reveal her strategy to consolidate the UK's £400bn local authority pension schemes, as reported by City AM.

Reeves believes these plans could potentially free up around £80bn for productive investments, thereby stimulating growth nationwide.

While her proposed changes may represent the most significant revamp of the local government pensions sector in decades, some City insiders argue that the truly transformative option for the pension industry is yet to be deployed.

Reeves refrained from suggesting that pension funds should increase their investment in UK stocks a point that has led some analysts to argue that the plans don't go far enough to unleash the much-anticipated surge in investment.

Simon French, chief economist at Panmure Liberum, commented: "Without addressing risk appetite/ home bias (or lack of) in allocation then we will see few of the advantages being claimed,".

Charles Hall, head of research at Peel Hunt, stated that the government still needs to implement "initiatives to increase investment into UK equities".

Chancellor of the Exchequer Rachel Reeves delivering her Budget to the House of Commons
(Image: PA)

These remarks echo a growing sentiment in the City that the government must take more active steps to encourage pension funds to invest in domestic assets.

Research from New Financial reveals that over the past 25 years, UK pension funds have drastically reduced their allocation to UK equities from 53 per cent to a mere six per cent.

UK pension funds have been found to be significantly under-invested in their domestic market compared to their international counterparts.

According to research commissioned by the Capital Markets Industry Taskforce (CMIT), UK pensions are “structurally underweight” in UK markets.

The research indicates that pension schemes in France and Italy are approximately 900 per cent overweight in their own domestic equities in comparison to the market size, while

Japan, Australia, and South Korea feature figures ranging from 1,000-3,000 per cent.

In stark contrast, the UKs largest funds are 40 per cent underweight relative to the market size, though New Financial reports this trend is less pronounced within public sector pensions, where the UK stands “firmly in the middle of the pack”.

As pension funds globally diversify and fund managers find it easier to invest overseas in foreign stocks, there has been a notable withdrawal of domestic capital.

Policy changes by Gordon Brown, namely the removal of dividend relief for UK pension funds, have accelerated the shift away from stocks towards bonds.

The idea of compelling pension funds to invest domestically has sparked controversy, particularly as critics highlight

that these funds have a fiduciary duty to their members rather than to support the struggling London stock market.

Nevertheless, Julia Hoggett, chief of the London Stock Exchange, said earlier this week that the retreat of domestic capital from UK equity markets has resulted in a “lovely self-referential logic”.

“As you strip money out of a market, the risk is it doesn’t perform as impressively, and then it becomes the justification for continuing to strip money out of the market,” she commented.

Gradually, the government has been nudging pension funds towards supporting domestic markets.

The Mansion House agreement has formally secured pledges from 11 leading pension fund managers to channel five per cent of their assets into private companies by 2030. Back in March, the then Chancellor Jeremy Hunt warned of “further action” against firms failing to increase their investments.

Nicholas Lyons, ex-Lord Mayor of London and chairman of Phoenix, the UK’s largest retirement firm, believes that the threat of mandation is most effective when not actually used.

He suggests that simply enforcing more transparency regarding pension funds’ asset allocations could significantly influence investment behaviours.

“Once people start having to be transparent about what they do, they tend to sort of read the writing on the wall,” Lyons observed.

A less contentious strategy might involve reducing taxes such as stamp duty on shares and dividend taxes to entice pension funds back into British businesses. This approach mirrors Australia’s system, where pension funds boast the world’s second-highest domestic equity allocation.

Yet, for now, Reeves is placing her bets on consolidation, suggesting that any ‘radical’ measures will stay off the table at least for the moment.

A spokesperson for the Treasury clarified: “These announcements do not include mandating investments, instead they are aimed at enabling funds to invest in a wider range of assets which will in turn benefit the UK.”

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