Ros Altmann: Mansion House reforms need to go a lot further

There is growing recognition that pension funds should take more investment risk

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With 2024 set to be an election year, the government needs positive headlines and feel-good economic news. I think this could happen.

An environment with sharply falling inflation, recession being avoided and earnings growth moderating but positive in real terms should enable base-rate cuts.

Of course, this assumes that geopolitical risks recede. If Middle East or Eastern European wars disrupt shipping and energy supplies severely, inflation and growth will be worse.

> **"This could finally be the year when domestic investors support British growth once more"**

Ministers want lower rates, because the current high levels worsen household debt, including mortgages, and increase debt-servicing costs of the huge post-Covid fiscal deficit.

I believe the Bank of England (BoE) should have reduced rates already because monetary policy is overly tight, so I hope for positive surprises. However, investors need to be careful in positioning long-term asset allocations because cuts may not be fully reflected in long bond markets.

Bonds face significant headwinds as the BoE has been selling the gilts purchased with newly created money since 2009.

Unwinding the extraordinary quantitative-easing (QE) purchases started only recently. This so-called quantitative-tightening selling pressure has been compounded by insurance companies selling gilts they receive from defined benefit (DB) pension scheme bulk annuity deals.

> **“Pension schemes could and should increase exposure to British markets and small quoted companies, not just unlisted investments”**

Trustees, encouraged by regulators and consultants to offload risk, are advised to hold more gilts, which attract better buyout quotes than portfolios with more ‘higher risk’ assets. But, once the gilts transfer to the insurance company, the insurer sells them to buy higher expected-return investments instead.

This additional gilt selling prevents sharp yield falls, especially once the bulk-annuity peak has passed and pension investors no longer need more gilts.

Indeed, the chance of sharply lower gilt yields is less than may be suggested by falling base rates. In the QE years of artificially low government bond yields, pension investors moved money into supposedly lower-risk fixed-income assets, away from traditional allocations to equities or other higher expected-return, growth-boosting investments.

Since QE ended, that has resulted in significant capital losses, as well as damaged UK markets.

Growing recognition

But there is growing recognition that pension funds should take more investment risk. At last, the government, regulators and investment experts are suggesting increased pension-fund exposure to growth assets, and reducing supposed 'liability-matching, lower-risk' bonds, which performed so poorly as QE ended.

> **"Even the Mansion House reforms can be invested overseas. This well-intentioned initiative is simply not ambitious enough"**

This could be a game changer for UK financial markets and the economy. British markets have lagged global performance, partly due to Brexit impacts, political uncertainty and pandemic disruptions. But some of the market de-rating is likely to be due to dramatically reduced domestic institutional support for our own markets.

Government policies to incentivise Isa and pension funds to invest in the UK — such as in infrastructure, tech stocks, early-stage companies, social housing or alternative and sustainable energy projects — can boost domestic growth, confidence and market performance through 2024.

There is talk of introducing a British Isa in the March Budget and I also hope the chancellor recognises the potential to do more to encourage both DB and defined contribution pension funds to invest in the UK.

Currently, more than £70bn a year of taxpayers' money (in pension tax and National Insurance reliefs) supports non-UK firms and countries. Using pension assets to fund much-needed investment is surely justified and would permit more tax cuts.

> **"At last, the government, regulators and investment experts are suggesting increased pension-fund exposure to growth assets"**

Even the Mansion House reforms, aiming to attract £30bn by 2030 into unlisted early-stage companies, can be invested overseas. This well-intentioned initiative is simply not ambitious enough to make a real