PENSIONS AND
LIFETIME SAVINGS
ASSOCIATION

FACILITATING INVESTMENT IN ILLIQUID ASSETS BY DEFINED CONTRIBUTION PENSION SCHEMES: PLSA RESPONSE

11 MAY 2022

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EXECUTIVE SUMMARY

- The PLSA welcomes the Government's drive to remove the barriers to illiquid investments by DC schemes, and we believe that these proposals are consistent with other disclosure requirements, in that they will result in more information being available to savers on where their pensions are invested. They also potentially prompt debate about investment strategies amongst trustees.
- Investment decisions are complex, and so we would be against any rules that would require trustees to invest a specific percentage in any asset class or type of investment, or that would present illiquids investments as being without risk. We recognise that, in the current form, the requirements are in line with the existing fiduciary duty.
- The challenges identified with the Chair's Statement – that it is too long and focussed on multiple audiences – are likely to be intensified by new requirements being added. We also have some reservations about whether the stated intended audience (pension scheme members) are likely to make use of this information in the way it is planned. We welcome recent steps to consider how the Chair's Statement might evolve to address these issues, and hope that the final proposals will be considered in light of that.
- We would suggest that the list of areas that should be disclosed in the Statement of Investment Principles needs to be reduced, in order to ensure that this new requirement does not become too burdensome for trustees. We believe a more 'high level' list fulfils both the policy intent, and the suggested length of the statement as set out in the consultation paper.
- We would also like to see the proposals on how asset allocation should be calculated to be based on the existing strategic asset allocation policy, rather than calculated as a quarterly average. It is unlikely that allocations will change so frequently as to justify such a requirement.
- We welcome the proposed changes to Employer Related Investments for Master Trusts.

ABOUT US

The Pensions and Lifetime Savings Association is the voice of workplace pensions and savings. We represent pension schemes that together provide a retirement income to more than 30 million savers in the UK and invest more than £1.3 trillion in the UK and abroad. Our members also include asset managers, consultants, law firms, fintechs, and others who play an influential role in people's financial futures. We aim to help everyone achieve a better income in retirement.

QUESTIONS

Question 1: Do you support these proposals and agree with the government's rationale for intervention?

The PLSA is supportive of the Government's plans to remove the barriers to investment in 'illiquids' by DC pension schemes, and welcomes many of the measures put in place to date, including the recommendations of the Productive Finance Working Group. Taken collectively, we hope that this will result in a wider range of investment options being practically available to pension schemes.

We continue to remain supportive of the current definition of fiduciary duty, in that we believe that trustees should retain full independence in making investment decisions on behalf of members. We would not be supportive of any new measures in which we considered that fiduciary duty was being eroded, and welcome the statement made within the consultation paper that confirms the DWP continues to recognise the importance of trustees retaining the right to make investment decisions on behalf of members. We note that the paper sets out that further investment in private markets 'could' result in improved outcomes for members. It is of course the case that all investments bring both opportunity and risk, including illiquids, and there is no guarantee that higher allocations will improve outcomes for DC savers. We are aware of a small number of examples where investment in illiquid asset classes via scheme default funds resulted in negative outcomes for members during the initial lockdown period in 2020. We are strongly of the view that trustees should have the independence to consider the full range of risks and opportunities associated with any investment decision. We would strongly oppose any requirement that would require trustees to favour a particular asset class or type of investment, or to meet a particular threshold, for these reasons.

As the disclosure proposals set out in the consultation paper - in relation to the Statement of Investment Principles and the Chair's Statement - are largely consistent with other disclosure requirements on trustees, the PLSA is open to supporting this additional transparency. As the paper sets out, not only does this provide an opportunity for members to engage with their pension, but it may also prompt consideration of illiquids investments by trustee boards. Indeed, as the paper suggests, many already choose to disclose this information.

However, below we have set out some suggestions on how the details of the proposal might be adapted to ensure that the requirements are not overly complex for trustee boards to administer, whilst still fulfilling the policy aims.

In particular, we note that ongoing debate about the purpose of the Chair's Statement and the conclusions of TPR's review in 2021[1], which largely reflects the feedback the PLSA has received from members. The review set out concerns that the current regulatory requirements result in Chair's Statements being too long, and with multiple audiences. It also notes that there is little

[1] https://www.legislation.gov.uk/uksi/2016/427/pdfs/uksiod_20160427_en.pdf

evidence that most pension scheme members are likely to read it, and that it therefore fails in its aim as a communications or member engagement tool.

The PLSA welcomes the commitment by the DWP to work with the industry on finding a solution, and we look forward to working with the department and industry partners to find a constructive way forward. However, in the meantime, we hope that consideration will be given to how these proposed new requirements will be accommodated within Chair's Statement in the future. We feel it is important that any new requirements should not effectively replicate the problems identified in the review.

We also note the ongoing frustrations of trustees at the cost and resource that the current volume of regulatory disclosures they are now required to produce – much of which appears to be subject to very little awareness among scheme members – and hope that consideration can be given to whether each new requirement is resulting in meaningful scrutiny and engagement.

Question 2: Do you agree with the scope of this proposal?

We largely agree with the intended scope, in that these proposals will apply only to the default fund of DC schemes.

However, we have some concerns generally about the impact of 'unintended defaults', which have come about as a result of the DWP's 'Bulk Transfer Without Consent' guidance, which states that transfer payments should be classed as contributions. For some of our members this has resulted in them having several default funds - even if only one is the 'true' default – and therefore need to meet all disclosure requirements on each (include SIPs and Chair's Statements). We hope that this will be taken into account in the drafting of any regulations linked to these proposals. We'd be happy to provide further background on this.

Question 3: Considering the policy objective to require trustees to state a policy on investment in illiquids, how should we define "illiquid assets"?

We recognise the challenges in defining this, but feel that both of the options set out in the paper have disadvantages. In keeping with the positions set out in other answers in this document, we are minded to favour a more high level definition that prompts trustees to consider their view of illiquids within their investment strategy, but does not become an administrative burden requiring the collection of additional data from managers and consultants.

With Option 2, for example, we would have concerns about the ease with which trustees, particularly those of small schemes, would have access to the level of detail it sets out. We have previously noted our concerns about expectations around 'look through' and the lack of clear or consistent statutory regulations or guidance on how this can be assessed and measured. We believe that any regulatory expectations that would formally introduce 'look through' expectations, without further clarity on exactly how they should be complied with, risk acting as a disincentive with regards to certain types of investments.

With Option 1, we note a risk that this definition may inadvertently encourage focus on the liquidity of the fund, rather than the underlying assets, and so may incentivise the 'wrapping' of assets in illiquid funds unnecessarily, when a more liquid wrapper is more appropriate.

That said, we're minded to feel the underlying exposure is more relevant than the liquidity. We feel that the consequence of this would need further consideration and would be happy to continue this discussion.

Question 4: Do you agree with the proposed aspects of a scheme's illiquid asset policy that we would require to be disclosed and timing of such disclosures?

We note that this section sets out that the expectation would be that the illiquid assets policy statement should be a "minimum one paragraph, maximum three paragraphs", and that it is not envisaged that trustees will have to spend significant time or resource forming a 'house view' of the issues that keep illiquid asset allocation low within DC pensions.

However, the subsequent sections of the paper sets out nine areas that the expected policy statement should contain, including what illiquids are, the benefits to members, and any current barriers to investment in illiquids.

Firstly, we don't agree that those areas can necessarily be set out within a 'short' high level statement as is proposed earlier in the paper – any statement covering all of those asks would be far longer and more detailed than is implied. We would prefer that any specified mandatory requirements of the statement are set at a much more general level than those listed. This is in part to meet the policy intent set out earlier in the paper that trustees should not be expected to spend time or resource forming a view on the wider debate.

We are slightly apprehensive that the expectations as set out appear to assume that investment in illiquids will automatically benefit scheme members, and that an explanation should therefore be offered as to why this is not being pursued on their behalf. As set out in Question 1, we feel the issues are far more nuanced that this suggests, and clearly trustees and advisors have a wide range of complex factors to consider. We would draw attention to the existing fiduciary duty, which requires that investment decisions are made within the interests of members, and that specific asset classes or themes (including ESG considerations) do not take priority over financial factors. We are concerned that asking trustees to justify to their members why they are not pursuing the 'benefits' of illiquids risks misleading them on the range of considerations that need to be made.

Though we note the paper set out an expectation that the intended audience for this would be scheme members – and we are certainly supportive of members having access to the investment philosophies of the scheme – we feel the opportunity with this kind of disclosure is really for trustees to review and act. Research generally suggests a large percentage of savers are unaware that their pension is invested on their behalf.[2] We therefore feel that this can be achieved by a more 'high level' disclosure requirement, which mandates that trustees set out the view on this and how

[2] https://corporate-adviser.com/only-a-third-of-people-know-that-their-pension-is-invested/

it is in the interests of members, without them having to set out in-house definitions and their view on the barriers the industry faces in relation to illiquids investments.

Question 5: Do you agree with the proposed level of granularity for this disclosure? Are the asset classes and sub-asset classes proposed in the example above appropriate for this kind of asset allocation disclosure?

Question 6: Do you agree that holding £100million or more of total assets is an appropriate threshold for determining which DC schemes should be required to disclose asset allocation?

Notwithstanding the concerns set out in Question 1 about the usefulness of the Chair's Statement in terms of engaging members generally, we are largely supportive of this information being made available to those who are interested. We believe that the categories and thresholds as set out in the paper are appropriate, and would be supportive of any further instruction being set out in non-statutory guidance, rather than regulations, as the paper suggests.

Question 7: Do you agree that we should align the disclosures with the net returns' disclosure requirement?

We are minded to agree that age specific data is an appropriate means of reporting this information.

We note that - given the consultation paper's clear expectation that this information is intended to be used as a tool to encourage member scrutiny - it is probable that either of the options outlined are likely to be imperfect (in that the data is potentially not accurate for all members of the scheme, and that the requirements set out in other regulations are not necessarily aimed at a non-professional audience). Nevertheless, we recognise that having a consistent ask on this across the Occupational Pension Schemes Administration Regulations and any future Value for Money framework is desirable, and unlikely to result in significant detriment to members.

Question 8: Do you agree with the frequency and location of the proposed asset allocation disclosures?

As set out in Question 1, we are currently in discussion with the DWP about the future of the Chair's Statement, which has been acknowledged by the DWP to not have fulfilled its policy expectations. We are supportive of discussions around whether it can be split in order to be more appropriately targeted at the various intended audiences, and look forward to that work progressing.

We therefore hope that any new additional requirements added as a result of this consultation will take into account the evolving debate on the Chair's Statement, and will ensure consistency whilst not adding meaningfully to costs and resource requirements.

We disagree with the proposals set out in the CP that would require an average allocation to be declared, based on four valuation points throughout the year, three months apart. We do not agree that it is likely that the asset allocations are likely to change as frequently as is suggested here, and instead believe that this requirement will increase the administrative burden on schemes, but provide no meaningful additional information to scheme members. We would therefore suggest that trustees are asked to set out their strategic asset allocation, rather than a yearly average on quarterly data points. It should be clear within the statement that strategy is set over the long term.

Question 9: Please provide estimates of any new financial costs that could arise from the proposed "disclose and explain" requirements. Please outline any one-off and ongoing costs.

We note, as set out in Question 1, the increasing costs of meeting the various disclosure requirements on pension schemes, as any significant costs could end up being passed onto scheme members, and hope this will be taken into account when finalising the new rules (particularly in areas we have flagged the unnecessary work the proposed rules would create). However, we have nothing further to add in terms of estimates.

Employer-related investments

Question 10: Do you think the current regulations relating to ERI in the 2005 Regulations present a barrier to Master Trusts expanding investment strategies to include private debt/credit?

Question 11: Do the draft regulations achieve our policy intent?

Question 12: Do you agree with the information presented in the impact assessment?

We welcome the proposals on Employer Related Investments as set out within the paper. Though we are not aware that the current rules have resulted in restrictions on investment decisions, monitoring compliance with the rules is clearly a lot of additional administration for Master Trusts. We support the rules being updated to reflect the changes in the market since they were first introduced. We also believe that the provisions within the new regulations, that will continue restrictions in relation to those associated with the scheme, are appropriate.

We agree that the draft regulations achieve the policy intent.

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