7 June 2022

Treasury Committee,
The House of Commons
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Dear Treasury Committee

CALL FOR EVIDENCE: THE VENTURE CAPITAL MARKET

We appreciate the opportunity to respond to the above Call for Evidence.

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.

Firstly, as the committee is no doubt aware, there has been considerable recent activity to encourage, or at least assist, pension schemes in allocating more money to 'illiquid', or 'productive' assets, including Venture Capital (VC). This includes the FCA/Bank of England/HM Treasury convened Productive Finance Working Group[i], the Prime Minister's 'Investment Big Bang' initiative[ii], the various policy considerations of the DWP[iii], and in relation to the rules on LGPS investments[iv].

The PLSA strongly supports the independence of trustees to make investment decisions in the interests of scheme members and taking into account their fiduciary duty, the investment environment, and their tolerance of risk. However, we do recognise that, in the case of DC pensions in particular, the wider environment is not necessarily conducive to making certain kinds of investments, even where trustees would like to make larger allocations. We therefore welcome much of the activity aimed at removing preventative barriers, particularly by the Productive Finance Working Group, of which the PLSA has been an active participant.

We agree with a number of the challenges that have been identified by the group, and welcome some of the developments that have been put in place to hopefully make it easier. These include:

- The new Long Term Asset Framework launched by the FCA, which aims to provide a vehicle for DC schemes to invest in less liquid assets, and which will hopefully provide investment opportunities that provide both reasonable liquidity and protection against gating.
- We recognise that the daily pricing environment in which DC schemes operate is not a necessity (either practically or through regulation) but that it is operationally challenging to move away from. We welcome the Working Group's efforts to engage platform providers to ensure they can accommodate access to non daily priced assets, such as VC.

- We recognise the challenge the report identifies in relation to the wider focus on cost and find this to be particularly prevalent in the commercial Master Trust market. We welcome the efforts of the FCA, TPR and DWP in developing a Value for Money framework that will take into account both cost and returns, and we continue to be engaged with the various bodies on this topic.
- Similarly, we acknowledge that trustees may need further support in handling the more complex considerations associated with some asset classes. This is something the PLSA has committed to supporting, alongside other membership bodies participating in the working group.

Nevertheless, we would note caution about assuming that these measures will result in immediate and significant allocations. We would like to draw particular attention to the following:

- As the Committee will be aware, the DWP has recently confirmed it intends to proceed with plans to exclude 'Performance fees' from the DC Charge Cap, despite significant reservations about the move from both the pensions sector and consumer groups. Given the continued caution around cost – and some concerns about the lack of transparency about the fees in some markets – we are apprehensive about assuming that this will make an immediate impact to allocations to the desired asset classes.
- In particular, we note that performance fees and carried interest are typical within VC, and the view of representative bodies that they are designed to only work in the interests of investors such as DC schemes. However, it's clear from our engagement with member schemes that they remain concerned about ensuring that any performance related fees are applied fairly across their membership, given different entry and exit points of members and the strong likelihood that some members would effectively be cross subsidising the gains of others. This may continue to make schemes cautious about accepting performance fees.
- We note the acknowledgement by the Working Group that the various bodies with a role in pension regulation could take a more consistent position on illiquid investments by schemes, particularly given challenges with the gating of some funds in the past. Whilst we recognise there has been a commitment to improve this moving forward, we believe that trustees continue to be mindful of recent moves to restrict illiquid investments by regulators, and may continue to be cautious to avoid any risk that their scheme would inadvertently become non-compliant as a result of such investments. It's worth noting that, in the past few weeks, the PLSA has responded to one regulatory consultation on a measure that we believe will further prevent illiquid investments, such as VC, by pension schemes[v].
- Finally, we would highlight the clear legal and moral obligation trustees have to fully consider risk in all investment decisions. The 'premiums' many note are associated with VC reflect higher risk associated with the investment. For DC schemes this represents a challenge given the daily valuations and liquidity they need to provide all members of the scheme. For DB schemes, various factors - such as the strength of employer covenant and maturity level - may lead them to choose to de-risk. We recognise that there is a place for riskier, less liquid allocations into asset classes such as VC but we would caution against assuming that the UK's pension savings are a resource to be 'unlocked' for this purpose. The

PLSA firmly takes the view that all policy considerations in relation to pension schemes must prioritise the needs of savers and beneficiaries.

Finally, we would note a few elements of investment in VC that we don't consider a risk or a barrier, but which the Committee may wish to be mindful of.

- 2022 marks the first year any pension schemes will have produced a mandatory Taskforce for Climate Related Financial Disclosure (TCFD) report, with all schemes expected to be required to do so in the coming years. The sector recognises the extent of the climate emergency we face, and there is across-the-board support for the need for pension schemes to fully consider and publish the extent to which they are exposed to climate risk. However, it remains the case that the required data they need to do so is largely not available to them, and we believe this is particularly true in alternative asset classes. The PLSA does not believe this should be a barrier to making such investments, and we recognise that TPR has given strong indications that it will take a proportionate view of the issue in the initial years. However, we hope that the VC sector will give consideration to its governance of climate risk - and in particular the disclosure of this information - in seeking institutional investment.
- Pension schemes, as long-term investors, are keen not only to select investments that will benefit them financially, but that will enable them to add value through active stewardship. Given the number of schemes that now have a net zero commitment in place[vi], as well as continued scrutiny of stewardship by Government and regulators, we would expect more focus by schemes on stewardship of their investments in the years to come. Historically this has been easier in some asset classes than others, and VC has not been known as an area in which investors might feel they could engage meaningfully. In considering the potential of attracting investment into VC by pension schemes, it is important to consider both the benefits to VCs and the likelihood that there will be opportunities and structures that will meet the needs of pension scheme investors.

We hope this information is helpful in your inquiry and we would, of course, be happy to respond to any further questions on it.

Best wishes,

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[i] https://www.bankofengland.co.uk/financial-stability/working-group-on-productive-finance
[ii] https://www.gov.uk/government/news/prime-minister-and-chancellor-challenge-uk-investors-to-create-an-investment-big-bang-in-britain
[iii] https://www.gov.uk/government/consultations/facilitating-investment-in-illiquid-assets-by-defined-contribution-pension-schemes
[iv] https://www.gov.uk/government/publications/levelling-up-the-united-kingdom
[v] https://www.plsa.co.uk/Policy-and-Research/Document-library/Proposed-revisions-to-ASTM1-PLSA-response

[vi] https://www.plsa.co.uk/press-centre/news/article/around-three-quarters-of-pension-schemes-have-or-soon-will-have-net-zero-plans-in-place