PENSIONS POLICY INSTITUTE
PPI

DC scheme investment in illiquid and alternative assets - Launch Write-up

The Pensions Policy Institute (PPI) held a policy seminar on 25th March 2019 to launch ***DC scheme investment in illiquid and alternative assets***, sponsored by BlackRock. The report sets out the potential benefits and challenges of investing in illiquid and alternative assets, and discusses how barriers may be overcome.

Over 50 people representing a broad range of interests within Government, the investment industry, the pensions industry and the third sector attended the seminar.

Chris Curry, **Director**, **PPI**, chaired the event.

Daniela Silcock, **Head of Policy Research**, **PPI**, presented the findings of the research.

David Farrar, **Senior Policy Manager**, **DWP**, presented a response from the Government, giving reflections on the report as well as an insight into DWP's principles in facilitating investments. He said that the research suggested that there were potential benefits to be attained through alternative investment, and that these could be achieved within the charge cap, particularly among investors who have already achieved considerable scale. Members in smaller schemes are more likely to be missing out on the potential benefits of alternative investment.

Alex Cave, **Head of DC Platforms**, **Blackrock**, presented a response to the research. He said that the sophistication and structure of DC investment has previously lagged behind that of Defined Benefit (DB), but there has been much recent activity, including regulatory, that has the potential to change this, and that while there is still some way to go in terms of innovation, there is a lot happening already. He suggested that more flexibility in the charge cap could encourage more investment in illiquid and alternative assets, and emphasised the importance of Government continuing to work with industry to improve the infrastructure for investment.

Mark Fawcett, **CIO**, **NEST**, presented a provider's response to the research. He said that accessing alternative investments is an important part of DC catching up with DB, particularly as increasing numbers of companies are remaining unlisted for longer. These alternative assets may be particularly important for schemes with a membership that is skewed towards younger ages, such as NEST, who will be more able to achieve an illiquidity premium as a result of their long investment horizons.

Panel discussion and Q&A

The following points were raised during the panel discussion and Q&A session, held under the Chatham House rule. They do not necessarily reflect the views of the PPI or all panellists.

Scale

- Increased allocation to alternative and illiquid assets is likely to be gradual, with large schemes moving first, followed by slower take-up among smaller schemes.
- There are, however, ways for smaller schemes to access these types of assets, and depending on the nature of the rest of their investments and the costs associated with this, they may have considerable headroom within the charge cap to fund this.

Charges and charge cap

- While there may be room within the charge cap for allocation to alternative and illiquid assets, the cap may drive investors towards very small allocations. However, with scale this may become less of a problem.
- There was discussion of whether asset managers should simplify charge structures to get rid of performance fees, as the variability of these fees can be challenging to communicate to members, and they may restrict allocation to alternatives and illiquids. However, the point was made that improved returns take hard work to achieve and asset managers should be rewarded for achieving them, although the industry may need to think more creatively about charging structures.
- The majority of private equity managers may not be willing to change their charging structure for pension schemes as they are able to levy this level of fee from other types of investor. As pension fund scale increases, they may have more leverage over managers and charging structures.
- It was suggested that any change to the charge cap would need a phase in period. If the charge cap is reduced in the 2020 review, schemes would need to be given a reasonable amount of time to comply which reflects the illiquidity of their existing investments.

Consultants and expertise

- Emphasis on the importance of having capability and managers in place to be able to access private market benefits, with potentially a small allocation to start, built up gradually over time.
- The role of intermediaries and consultants is often overlooked in discussions with government and regulatory bodies about how to improve the investment landscape.

- Smaller schemes are often more dependent on consultants as they are less likely to have trustees with considerable investment expertise. This highlights the importance of driving up knowledge of ESG and illiquids among both trustees and intermediaries.
- Larger schemes are likely to be most affected by the consultation proposals, and these trustees are more likely to have investment expertise, and therefore less reliance on consultants.
- Bringing this sort of investment expertise in-house could reduce the costs associated with alternative and illiquid assets, but increased allocation to these assets could potentially be achieved more quickly on a collective basis.

Supply and demand

- Although there is demand for increased allocation to alternative and illiquid assets, some providers are still figuring out how best to do it.
- There may also be “crowded market” issues around supply of these types of assets, which will only increase as demand for this type of investment increases.