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DC scheme investment in illiquid and alternative assets

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Welcome from the Chair

Chris Curry,
Director
Pensions Policy Institute

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Key Findings

Daniela Silcock,
Head of Policy Research
Pensions Policy Institute

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DC scheme investment in illiquid and alternative assets

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There are potential benefits of DC scheme investment in illiquid and alternative assets…

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So why don't more DC schemes do it?

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What might make things easier?

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- Growth, consolidation, fund pooling and the closure of some small schemes,
- Changes to, and clarification of, regulations,
- Methods of calculating the proportion of funds which can safely be invested in illiquids,
- An increase in demand from schemes,
- Advancements in education and a holistic communication approach.

Growth, consolidation, fund pooling and the closure of some small schemes…

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- Natural scheme growth should lead to cost reductions
- Advancements in pooling and consolidation should help with smaller schemes
- Some small schemes will continue to struggle

Changes to, and clarification of, regulations…

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… should make it easier for DC schemes to understand the available investment options.

- Permitted Links, development of authorised funds (FCA 2018)
- Increasing scale and changes to charge cap compliance techniques (DWP 2019)
- Encouragement by Government

There are methods of calculating the proportion of funds which can safely be invested in illiquids, for example…

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The proportion of funds a scheme can safely invest in an illiquid asset, based on the level of illiquidity

Period over which asset cannot be traded	Optical allocation of AUM
Ten years	4.8%
Four years	13.2%
Two years	25.1%
One year	37.3%
Half a year	44.2%
Always tradeable	59.3%

An increase in demand from schemes should ideally result in investment and development by platforms…

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- Alternative funds are not widely available because of:
  - Platform constraints, particularly around the regularity of asset valuations, and,
  - Subdued demand due to the administrative complexity associated with investment in illiquid and alternative assets.
- Changes in the marketplace, could increase accessibility and encourage innovation and development by asset managers.

Advancements in education and a holistic communication might be necessary…

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- DC schemes receive most of their information from intermediaries who could be incorporated into education campaigns that aim to help providers and trustees to understand their options and the potential benefits of investing in illiquid and alternative assets.
- Education may need to be undertaken directly with consultants, advisers and platform managers before being undertaken with DC scheme providers.

Conclusions

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- Greater DC scheme investment in illiquid and alternative assets could potentially yield benefits to pension scheme members,
- However there are challenges facing interested schemes, in particular the lack of funds on platforms and difficulties around charge cap compliance,
- The Government and regulators are working on removing barriers though development from asset managers, DC platforms and flexibility from fund providers will be necessary to create more accessibility.

Department for Work & Pensions

DC scheme investment in illiquid and alternative assets

Response from Government

David Farrar, DC Investment and Governance

Summary

- Reflections on the report
- DWP’s principles in facilitating illiquid investments
- The changing DC landscape
- Government’s consultation

Reflections on the report

- A behavioural cap not a legislative one
- The illiquidity premium is at least plausible
- Scale is already present in DC
- Models are available to identify optimal allocations
- Hedge funds are still rubbish

Asset	Returns, gross of charges				Long-term expected volatility	Long-term co
	5 years	10 years	15 years	20 years		Global equities
Liquid assets						
UK gilts all maturities	-0.1%	0.8%	1.6%	2.1%	6.9%	-21%
UK corporate bonds all maturities	1.3%	2.2%	2.9%	3.4%	6.4%	20%
UK large capital equities	7.1%	7.5%	7.8%	7.9%	15.5%	87%
European equities	7.1%	7.6%	7.9%	8%	16.6%	87%
Illiquid and alternative assets						
Hedge funds (global)	4.6%	5.2%	5.7%	6.0%	7.6%	84%
Real estate mezzanine debt	4.5%	5.2%	5.7%	6.0%	10.7%	46%

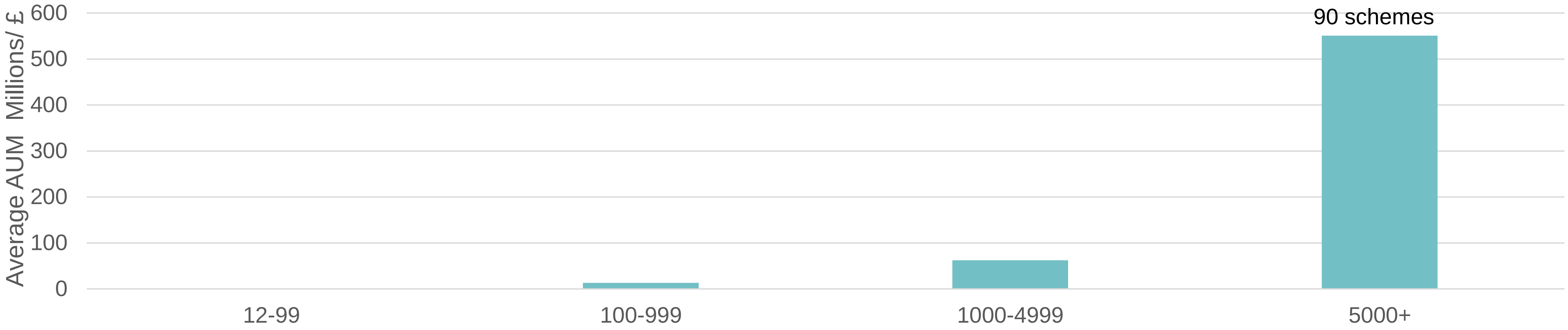
DWP's principles in facilitating investments

"It remains Government policy not to direct the investment decisions or strategies of trustees of pension schemes. We will never exhort or direct private sector schemes to invest in a particular way. Trustees have absolute primacy in this area."

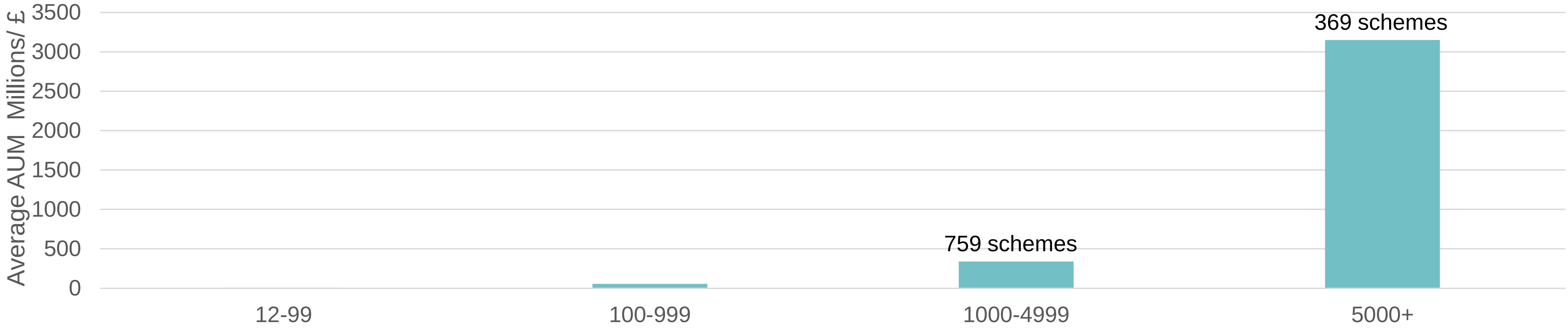
Guy Opperman MP

- No direction
- Never more than a nudge to consider
- No home bias
- No claims of outsize returns
- No asset allocation bias, beyond a 0.75% charge cap

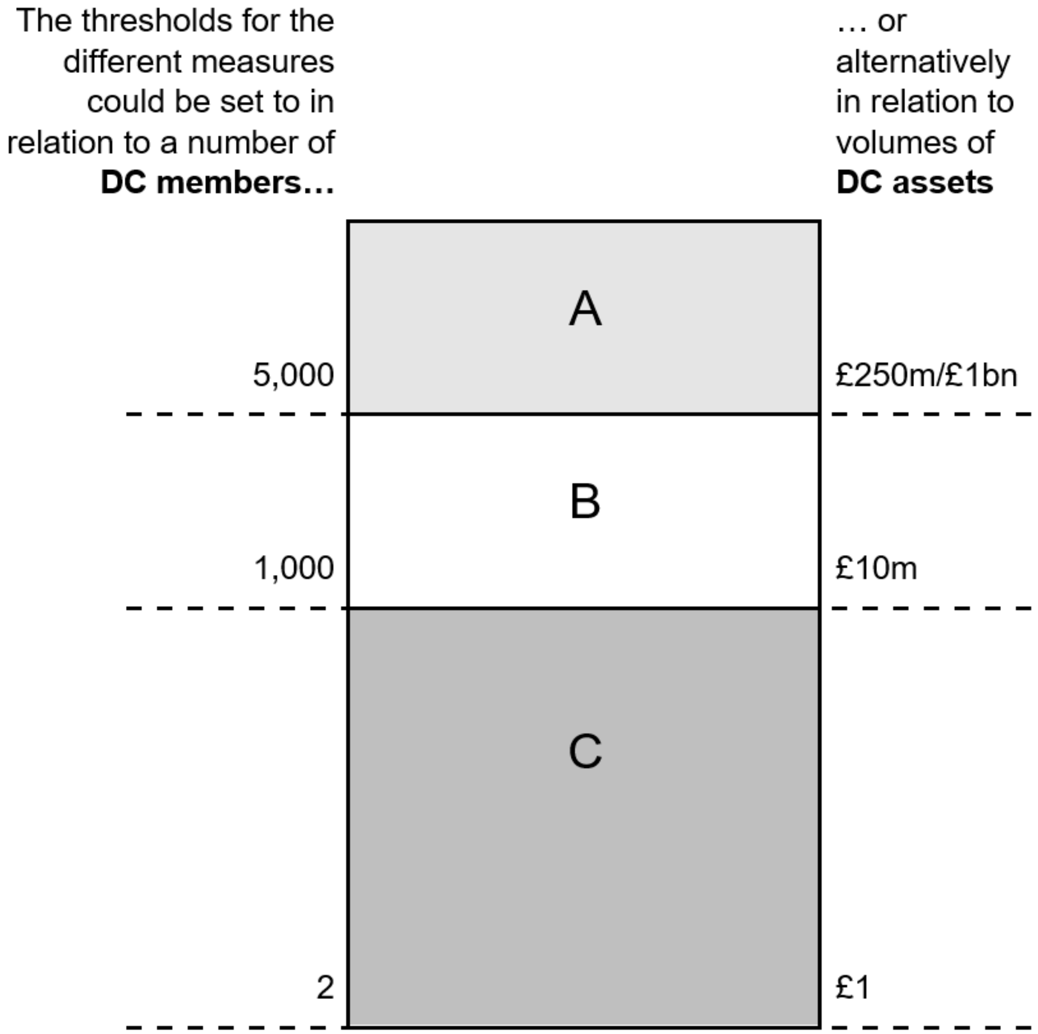
Changing DC landscape



But compared with DB …



Our consultation 1



A	Addition to Statement of Investment Principles and Implementation statement on policy and approximate holdings in relation to illiquid assets
B	No requirements
C	Triennial Statement as part of Chair's Statement on whether members would receive better value in a larger scheme.

Our consultation 2

Performance fees - Additional method of assessment

$$\frac{\text{Fixed rate fee (if no change in funds under mgmt)(£)} + \text{Max performance related fee (£)}}{\text{Year start funds under mgmt (£)}} \leq 0.75\%$$

Consultation details

https://bit.ly/illiquids - open until 1st April

Respond to

Sinead Donnelly and David Farrar

pensions.investment@dwp.gsi.gov.uk

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Response to research findings

Alex Cave,
Head of DC Platforms,
BlackRock

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Response from provider

Mark Fawcett,
CIO
NEST

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Panel Discussion

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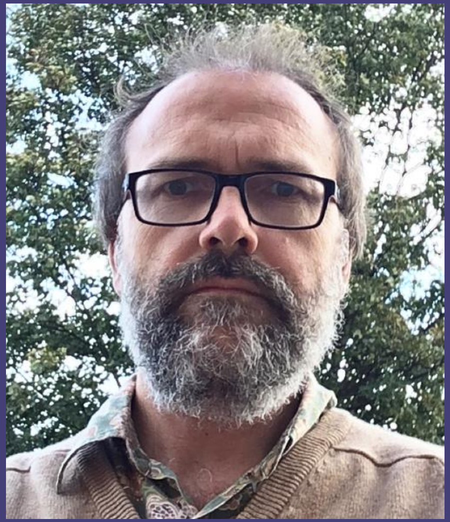
Alex Cave
BlackRock



David Farrar
DWP

Daniela Silcock
PPI

Mark Fawcett
NEST

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Questions and Answers Session

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Closing Remarks

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