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DC Policy, Investment and Governance Team

Department for Work and Pensions

By email: pensions.investment@dwp.gov.uk

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Facilitating investment in illiquid assets

We, the Association of Real Estate Funds[1] (AREF), have read with interest the consultation responses on exempting performance-based fees from the regulatory charge cap. We are pleased that the government are planning to engage further on reducing the scope of the charge cap to better accommodate well-designed performance fees that facilitate investment in long-term, less liquid assets. These types of assets can offer defined contribution pension schemes (DC schemes) capital growth and higher returns as well as supporting investment diversification.

We support the government's intention to consult on principle-based draft guidance in relation to any changes to the scope of the charge cap alongside any consultation on draft regulations.

We would like to reiterate that we disagree that performance fees are actually a charge. Performance fees typically arise where a fund or portfolio delivers a return to investors that exceeds a pre-determined benchmark or hurdle. Carried interest, or a performance fee with similar characteristics, is not therefore really a fee at all, but rather a profit share and incentive allocated to the manager when the fund manager has delivered outperformance for the investor.

Please find below our response to the consultation on introducing disclose and explain policy proposals. We have not provided any feedback on employer-related investments or the case for greater consolidation in the defined contribution pensions market.

If you would like to discuss our response with us, please contact either myself (prichards@aref.org.uk) or Jacqui Bungay (jbungay@aref.org.uk), Policy Secretariat at AREF. Also, as our members invest in real estate and other real assets for various types of open-ended and closed-ended funds, in the UK and in other jurisdictions, we are always willing to assist DWP by sharing this wealth of knowledge and expertise.

Yours sincerely

Paul Richards
Managing Director, The Association of Real Estate Funds

[1] The Association of Real Estate Funds represents the UK real estate funds industry and has around 60 member funds with a collective net asset value of more than £72 billion under management on behalf of their investors, including £18 billion on behalf of retail investors in the UK. The Association is committed to promoting transparency in performance measurement and fund reporting through the AREF Code of Practice, the AREF/IPD UK Quarterly Property Funds Index and the AREF/IPD Property Fund Vision Handbook.

AREF
The Association of Real Estate Funds

Response to consultation questions in Chapter 2: Introducing Disclosure and Explain Policy Proposals

Policy Proposals and Rationale for intervention

Q1: Do you support these proposals and agree with the government's rationale for intervention?

We support the proposal that schemes should disclose and explain their policies on illiquid investment in their Statement of Investment Principles (SIP). We agree that this requirement will focus the minds of those overseeing and making investment decisions for DC schemes on the relative value the schemes are offering to their members. We believe that transparency is important; AREF has a leading role in improving disclosures for property funds for both defined benefit and defined contribution pension investors.

The disclosure of asset allocation and investment policy provides scheme members with the opportunity to gain greater understanding of their investments. Although, we would argue that most scheme members do not look at their pension reporting and there is a space for government to educate the public on the importance of understanding how their money is invested in their pensions.

As acknowledged in the consultation, the policy proposals set out chapter 2 do not represent 'the solution' to the barriers to accessing illiquid investments. We agree that investment platforms should innovate to accommodate long-term illiquid investments.

We agree strongly with the need to focus more on value and less on cost. This was the key message in our response to the Government's consultation on enabling investment in productive finance.

Amendments to the Statement of Investment Principles (SIP)

Scope of proposed disclosure and explanation requirements

Q2: Do you agree with the scope of this proposal?

We support the proposal to require DC schemes to include an explanatory statement on their policy towards investment. We also agree with the reasons given to exclude DB schemes from the proposed policies.

Definition of illiquid assets

Q3: Considering the policy objective to require trustees to state a policy on investment in illiquids, how should we define "illiquid assets"

The difficulty of defining "illiquid assets" is acknowledged in the consultation. In reality there is a spectrum of relative liquidity and also, the liquidity of assets can change under certain conditions. We believe that a better approach is to provide a more nuanced commentary that addresses the relative liquidity of the underlying assets and the vehicles through which they are held. Taking the example of real estate, the underlying property may have very different liquidity characteristics. A large shopping centre may be much less liquid than individual apartments. The way in which investments in the property are made may also have very different liquidity characteristics, for example, direct investment, debt, closed-ended funds, open-ended funds or listed REITs.

Requirements and timeframe for disclosure of illiquid asset policies

Q4: 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 agree that the proposed disclosures, in section 98 of the consultation document, should be referred to in DC schemes' illiquid assets policy statement. Providing the statement within the currently SIP reporting timeframe of "at least every three years and without delay after any significant change in investment policy' seems sensible and proportionate.

As we have already mentioned, the current culture of many DC schemes and their investment platforms to require daily dealing is a key barrier to the schemes investing in illiquid assets. If the reason why schemes are not investing in illiquid assets is because daily dealing in these assets is not available they should be expected to justify this in their illiquid assets policy statement. They should explain why daily dealing is in the best interest of their members over investing in illiquid assets. Usually a good proportion of the investments in a DC scheme are not required to be converted to cash immediately so notice periods or deferrals for redemptions should not be an issue for DC schemes. Also, we would suggest that if trustees are having difficulty finding investment platforms through which they can invest in illiquid assets this should be noted as a barrier to investment in illiquid assets.

Asset allocation disclosure

Proposal

Q5: 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?

We agree with the proposed level of granularity for the asset allocation disclosure and in the main with the proposed asset classes. Although, we would suggest that there is a “Real assets” asset class with the sub-asset classes of “Property”, Infrastructure” and “Real asset debt” as many investors group these together.

The proposed disclosure of asset allocation will provide scheme members with a better understanding of where the scheme is investing their money.

We support the proposal to produce guidance on how trustees should disclose this information as it will ensure consistency in reporting across schemes. Also, it is easier to adapt guidance, rather than regulation, as and when the investment market and processes evolve.

Scope

Q6: 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?

We have no opinion on this.

Age specific disclosures

Q7: Do you agree that we should align the disclosures with the net returns’ disclosure requirement?

We have no opinion on this.

Frequency and location of asset allocation disclosures

Q8: Do you agree with the frequency and location of the proposed asset allocation disclosures?

An annual disclosure of asset allocation within the Chair’s Statement seems sensible to us.

Next Steps

Q9: 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 are not in a position to respond to this question