

11 May, 2022

DC Policy, Investment & Governance Team
Department of Work & Pensions
Caxton House
Tothill Street
London SW1H 9NA

Submitted by e-mail to pensions.investment@dwp.gov.uk

Dear Mr Opperman,

CFA UK response to the DWP regarding the open consultation on ‘Facilitating investment in illiquid assets’

The CFA Society of the UK (CFA UK)¹ is pleased to respond to the DWP on the important topics of asset allocation disclosure and Employer Related Investments (“ERI”). Please see Appendix II for detailed responses to the questions asked.

We are in agreement with the majority of proposals and believe that they provide a sound foundation for opening up illiquid asset classes to DC schemes. On the whole, they strike the right balance between providing useful additional information to scheme members without being too onerous for schemes to comply with. We are supportive of the DWP’s desire to enable DC schemes to invest in as broad a range of assets as possible but wish to highlight the below considerations for the policy proposals:

Asset allocation disclosure for schemes with under £100m in assets under management

We believe that all pension savers should have the right to know how the assets in their scheme’s default investment option are allocated. A member who has their retirement savings in a smaller scheme should not be at an informational disadvantage simply due to a scheme’s size. Asset allocation is fundamental to the investment decision making process and should be shared with pension savers.

Prescriptive regulation

We agree with the DWP that it must be the responsibility of trustees to decide where to invest and that mandating investment in certain asset classes would cut across fiduciary duty. We would further note that regulation that is overly prescriptive in terms of definitions and/or investment limits could constrain the investment innovation that the policy intends to facilitate.

Consolidation

CFA UK broadly concurs with the DWP in their assessment of the benefits of greater consolidation in the pensions market.

Excluding performance fees from the charge cap

CFA UK also welcomes the approach now adopted by the DWP in their proposal to exclude

¹ CFA UK’s mission is to help build a better investor profession for the ultimate benefit of society. We refer you to Appendix 1 for a brief overview of both CFA UK and our umbrella organisation, CFA Institute.

performance fees from the charge cap as we indeed argued in our letter² on this issue last year. We believe that this approach is a significant step towards ensuring that the total fees paid for private market assets is more flexible going forward. This reform allows for consideration of a wider asset universe and diversification into assets with potentially higher returns.

We are pleased to provide in Appendix III details of previous relevant reports/regulatory response letters published/submitted by CFA UK and of one very relevant CFA Institute whitepaper on the future European pension landscape with regard to investment in illiquid assets.

Should you have any questions or points of clarification regarding this letter or our responses to the questions, do not hesitate to contact us.

Yours sincerely,



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With thanks to contributions from:

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and the oversight of the [CFA UK Professionalism Steering Committee](#)

² CFA UK response to DWP on further Consultation re: incorporating performance fees within the charge cap (April 2021): <https://www.cfauk.org/-/media/files/pdf/pdf/5-professionalism/2-advocacy/responses/charge-cap-ii-cfa-uk-final.pdf>

APPENDIX I: About CFA UK and CFA Institute

CFA UK serves nearly twelve thousand leading members of the UK investment profession. Many of our members work with pension funds, either managing investment portfolios, advising on investments, or as in-house employees responsible for pension investment oversight.

- The mission of CFA UK is to build a better investment profession and to do this through the promotion of the highest standards of ethics, education and professional excellence in order to serve society's best interests.
- Founded in 1955, CFA UK is one of the largest member societies of CFA Institute and provides continuing education, advocacy, information and career support on behalf of its members.
- Most CFA UK members have earned the Chartered Financial Analyst® (CFA®) designation or are candidates registered in CFA Institute's CFA Program. Both members and candidates attest to adhere to CFA Institute's Code of Ethics and Standards of Professional Conduct.
- For more information, visit www.cfauk.org or follow us on Twitter @cfauk and on LinkedIn.com/company/cfa-uk/.

CFA Institute is the global association for investment professionals that sets the standard for professional excellence and credentials.

- The organisation is a champion of ethical behavior in investment markets and a respected source of knowledge in the global financial community. Our aim is to create an environment where investors' interests come first, markets function at their best, and economies grow.
- It awards the Chartered Financial Analyst® (CFA) and Certificate in Investment Performance Measurement® (CIPM) designations worldwide, publishes research, conducts professional development programs, and sets voluntary, ethics-based professional and performance-reporting standards for the investment industry.
- CFA Institute has members in 162 markets, of which more than 170,000 hold the Chartered Financial Analyst® (CFA) designation. CFA Institute has nine offices worldwide and there are 158 local member societies.

For more information, visit www.cfainstitute.org or follow us on Twitter at @CFAInstitute and on Facebook.com/CFA Institute.

APPENDIX II: Responses to questions

CHAPTER 2: INTRODUCING DISCLOSE & EXPLAIN POLICY PROPOSALS

Q1. Question 1: Do you support these proposals and agree with the government's rationale for intervention?

Yes. We believe that a DC pension fund's long-term liability profile translates to an increased ability to allocate to illiquid investments which represents a competitive advantage when compared to other investor types.

As the UK DC market matures, there is a need to diversify investment portfolios and to consider an allocation to less liquid assets. Requiring trustees to consider as diverse a range of assets as possible and how these allocations could improve member outcomes should lead to their incorporation into DC investment strategies. This will help to align members' long-term investment horizon with long-term investment opportunities.

We agree with the government's belief that placing requirements for a certain percentage of total assets to be allocated to private market should not be pursued. We would further add that setting restrictions on specific illiquid allocations should also not be pursued. Limits based on the location of the asset (for example investments inside the UK) or constraints on specific sub-asset classes within private markets would be against the policy proposals. Restrictions of this kind would also cut across fiduciary duty and could lead to sub-optimal outcomes for pension members.

It should be noted that policy intervention has already been successful in requiring trustees to consider ESG factors and we believe that comparable policy regarding illiquid investments should result in a similar achievement.

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

We agree that the proposals should only apply to occupational DC schemes and not to DB schemes, and that the proposals should apply to default arrangements only. The vast majority of DC pension scheme members are saving into the default investment fund so a policy that covers this investment option would naturally cover the majority; for self-select options, we would be happy for no requirement as proposed, but suggest this could be made voluntary encouraging a common sense approach to be adopted by the scheme depending on what the self-select option actually is and the relevance of illiquid investments to it.

While we understand the government's wider policy objective to consolidate the DC market, it should also be noted that by applying the illiquid policy proposals to all DC schemes, smaller schemes will be disproportionately affected. Consultants would need to be engaged by smaller schemes in order to update their SIP with regards to their approach to illiquid assets when in reality this is an asset class that they may never allocate to.

As we have stated on previous submissions to both the FCA, TPR and DWP we believe it is helpful if UK pensions regulation is as consistent as possible across all three regulators and, to this end, we encourage the FCA to consider comparable rules for the contract based market.

Q3. Considering the policy objective to require trustees to state a policy on investment in illiquids, how should we define “illiquid assets”?

Of the two options presented, we would advocate Option 2 over Option 1. Illiquid assets, and therefore the potential to capture illiquidity premia, are largely defined by what they are invested in and so an asset level definition would be preferred. Asset allocation disclosures would require a look through of multi asset funds in any case, so it is reasonable and proportionate to define illiquid assets at the granular asset level. We are also conscious that the risk/return spectrum is as broad or even broader within actual illiquid investments compared to investments in liquid/public markets.

Notwithstanding our preference for Option 2, we would also highlight some practical considerations of implementing this definition. Asset managers do not always disclose their granular investment holdings and some schemes have systems limitations that may mean a look-through presents resource challenges. We would encourage the DWP to coordinate with the FCA on mandating asset level disclosure for asset managers to their pension scheme investors to ensure granular asset allocation reporting is possible for pension schemes.

Two alternative options we have considered are:

- i. to follow the definitions of Level 1, 2 and 3 assets under the IFRS 13 accounting standard for financial assets, bucketing the assets into the three levels. We are cognisant that the definitions of these levels refer more to valuation uncertainty than to liquidity. However, IFRS 13 Appendix B provides guidance which may be helpful on the characteristics of a market that is illiquid; or
- ii. making the distinction as simple a one as to whether the asset is listed or not, though we are conscious that the mere fact of a listing far from guarantees liquidity.

We also recommend the DWP take into consideration the FCA’s definition of “inherently illiquid assets” to ensure consistency of approach.

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 with the aspects of a scheme’s illiquid asset policy as detailed in the proposals, and we support the aim of not wanting trustees to spend disproportionate resources or time applying these proposals. However, it should be noted that the policy proposals will take time to be implemented and included in the SIP. Trustees will require training on illiquid assets and over the course of a few meetings (usually only quarterly in nature), will define their policy on illiquid assets.

With regards to the timing of the disclosures, we would encourage setting a deadline for when the initial disclosures should be made. While a significant change to investment policy would trigger an update to the SIP without delay, some schemes may defer altering their investment policy thereby postponing application of the policy proposals. After the initial disclosure, we agree with aligning subsequent disclosures with the current SIP requirements of “at least every three years”.

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 that the proposed seven main asset classes (cash, tradable bonds, listed equities, private equity, (unlisted/direct) property, (unlisted) infrastructure, and private debt) are the right level of granularity for asset class disclosures, particularly member facing disclosures along with an additional 'Other' category to capture investments in certain commodities or currencies, for example.

We would caution against the use of further sub-asset classes:

- Adding another tier of disclosure is likely to be too much for pension savers to make sense of and could hinder the policy aim of comparability across pots and identification of asset class drivers of return.
- The use of additional tiers of sub-asset classes could also result in overlap and ambiguity about which sub-asset class an investment should be classified as. Again, this could lead to misleading information and a lack of comparability.

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?

No. We believe reporting of asset allocation should be standard across the DC market landscape. Asset allocation is arguably the biggest driver of investment return and not reporting this information could be considered contrary to trustee duty.

We believe that all pension savers deserve to know how their pension savings are allocated. Requiring all schemes to report on their asset allocation will enhance value for money assessments and support transparency across schemes on investment strategies.

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

We can support consistency of approach with existing disclosures and the proposal to disclose asset allocation in accumulation for savers aged 25, 45 and 55.

However, for this format option we would further suggest inclusion of a further saver age at the end of the accumulation phase since the asset allocation at this point is likely to be significantly different to that which applies for a saver aged 55. We would recommend that the additional age category be set at 65.

Where a scheme communicates their default lifestyle strategy by years to retirement, however, we would propose that they also have the right to prepare their disclosures bucketed in this way. While we support the desire for consistency noted above, as noted in the consultation, schemes' glidepaths (and hence their asset allocation changes towards decumulation) are often dictated by "years to retirement" rather than by a members age. Including additional transparency on how asset allocation changes as a saver approaches retirement will enhance member disclosures and support member

engagement. It will also support the policy intent of improving scheme comparability for members.

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

We agree that the proposed asset allocation disclosures should form part of the annual Chair's statement and should be available publicly.

However, we recommend disclosure of a scheme's default strategic asset allocation (SAA) only, rather than using an average allocation throughout the year. Historically, asset allocation has rarely moved significantly throughout the year unless there has been a change in investment strategy. Whilst funds may become more dynamic in the future a single annual report should provide the appropriate and relevant information for members. By contrast, agreeing four valuation points throughout the year and then further ensuring consistency of these points annually through time would add unnecessary complexity and cost. Having different schemes choosing different points may also skew the average and could impact the comparability of schemes for members.

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.

Each scheme will need to consider the costs of training for trustees, the additional work required to the Chair's statement and the production of an updated SIP. We are not in a position to report detailed estimates on financial costs but would consider that the total amount would depend on individual schemes' requirements, the consultancy used and the scale of the changes required when compared to a schemes current practices.

It should also be noted that smaller schemes will bear a relatively higher burden of the financial cost of these changes. For these schemes, the changes are likely to be resource intensive and require substantial consultant input, resulting in much higher financial costs.

CHAPTER 3: EMPLOYER RELATED INVESTMENTS

Q10. 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?

Yes. We believe that the current regulations do present a barrier to Master Trusts expanding into private debt/credit but also additionally some US (TRACE) bonds and private convertible loan notes.

Master Trusts can consist of thousands of unrelated companies. The resource and cost of checking potential private credit investments against this list, including connected or associated parties, is a burdensome on-going task – particularly if then required to be monitored throughout the life of the investment.

The current restrictions that ban direct investment in certain loans also mean that private debt investments would need to be appropriately structured (for example in Collective Investment Vehicles) in order to be considered for investment by a Master Trust. Again, this is potentially resource intensive, adding higher charges, and is likely to therefore result in a smaller investment universe being considered by trustees.

We would also highlight that while the question refers specifically only to private debt/credit, proposed regulations should also consider their application to wider asset classes (such as bank loans, trade finance and asset backed securities) and ensure additional barriers to Master Trust investment in this regard do not occur.

Q11. Do the draft regulations achieve our policy intent?

Yes.

The Master Trusts landscape and governance model has many differences from multi-employer and single-employer schemes. The draft regulations reflect the fact that the risk of influencing the investment strategy is mitigated in the Master Trust model. This risk is also minimised the more employers a Master Trust consists of.

The intent of the policy is to address misappropriation of scheme assets, which in the Master Trust model would exist for ERI in the scheme strategist, scheme funder, or a person who is connected with or an associate of the scheme funder or scheme strategist (including the trustees). We believe the draft regulations achieve this and recognise the distinct relationship between the scheme and the multiple participating employers using the scheme.

Q12. Do you agree with the information presented in the impact assessment?

While we do not disagree with the approach taken in the impact assessment, we would recommend additional consideration of the role that investment consultants will play in any change to regulation. “Specified schemes” are likely to solicit investment advice and/or training for this change of regulation, particularly where the current restrictions have narrowed the desired investment universe.

Appendix III: Previous relevant CFA UK & CFA Institute Publications:

A) White Papers:

- Value for Money: A Framework for Assessment (November 2018):
<https://www.cfauk.org/-/media/files/pdf/pdf/5-professionalism/3-research-and-positionpapers/value-for-money--a-framework-for-assessment.pdf>
- Innovations in Retail Fund Fees (November 2019):
<https://www.cfauk.org/professionalism/research-and-position-papers/innovations-in-retail-fund-fees#gsc.tab=0>
- CFA Institute policy position on Capital Formation (2020):
<https://www.cfainstitute.org/advocacy/policy-positions/capital-formation-investing-pension-contributions-in-private-markets>

B) Recent Consultation Responses:

- CFA UK response to the FCA and TPR regarding DP21-3: Driving Value for Money in Defined Contribution Pensions (December 2021): <https://www.cfauk.org/-/media/files/pdf/pdf/5-professionalism/2-advocacy/responses/letter-to-fca--tpr-dp21-3-final.pdf>
- CFA UK response to DWP on further Consultation re: incorporating performance fees within the charge cap (April 2021): <https://www.cfauk.org/-/media/files/pdf/pdf/5-professionalism/2-advocacy/responses/charge-cap-ii-cfa-uk-final.pdf>
- CFA UK response to DWP's Consultation – Improving outcomes for members of defined contribution pensions schemes (October 2020): <https://www.cfauk.org/-/media/files/pdf/pdf/5-professionalism/2-advocacy/responses/dwp-improving-outcomes-for-dc--oct-2020.pdf>
- Response to the FCA regarding CP20/9: CFA UK Response to CP 20/09: Driving Value for Money in Pensions (September 2020): <https://www.cfauk.org/-/media/files/pdf/pdf/5-professionalism/2-advocacy/responses/igc-vm-to-psc.pdf>
- Response to the FCA regarding MS17/1.2: Investment Platforms Market Study (September 2018): <https://www.cfauk.org/-/media/files/pdf/pdf/5-professionalism/2-advocacy/responses/cfaletter-to-kate-blatchfordhickfinal.pdf?la=en&hash=96A9B1F1AE37C588706DE59377574D38FC8D24CA>
- Response to the FCA regarding CP18/9: Consultation on Further Remedies – Asset Management Market Study (June 2018): <https://www.cfauk.org/-/media/files/pdf/pdf/5-professionalism/2-advocacy/responses/cfaletter-to-karen-northey.pdf?la=en&hash=D330FBFA4E022E4392EC47A7AE395EEDE44E8EC5>